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March 25, 2010

LEGEND

X =

GP =

LP1 =

LP2 =

LP3 =

LP4 =

LP5 =

LP6 =

LP7 =

State =

Date 1 =

Date 2 =

Dear :

This responds to a letter dated October 9, 2009, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting rulings under § 704 of the Internal Revenue Code.

X was formed as a limited partnership on Date 1 under the laws of State. X's limited partners consist of LP1, a voluntary employees' beneficiary association (VEBA), and Domestic Plans (LP2, LP3, LP4, LP5, LP6 and LP7) which provide for pension and welfare benefits of a common employer and its current and former subsidiaries ("the LPs"). X's general partner, GP, is its investment advisor ("Advisor") and is the investment advisor and manager of the Domestic Plans (GP collectively with LPs, the "Partners"). The LPs finance and administer retirement or welfare benefits of current and former employees, and beneficiaries thereof, of the common employer and its current and former subsidiaries. The Partners' business purpose for the creation of X is to pool investments in publicly traded securities to increase the efficiencies and cost savings through economies of scale in the management, administration, and custody of those investment assets.

None of the assets contributed by the Partners to X involve activities or transactions that will give rise to unrelated business taxable income (UBTI), as defined by §§ 512 or 514. X represents that none of the investment income earned by LP1, a VEBA described in § 501(c)(9), with respect to the assets that it contributed to X is treated as UBTI, because LP1 is a separate welfare benefit fund maintained pursuant to a collective bargaining agreement within the meaning of § 419A(f)(5)(A). On Date 2, the Service issued a private letter ruling to LP1, which concluded that LP1 is a separate welfare benefit fund maintained pursuant to a collective bargaining agreement within the meaning of § 419A(f)(5)(A). Accordingly, all of the income earned by LP1 with respect to X is exempt function income under § 512(a)(3)(A) that is not UBTI.[1]

1 We note that a VEBA could still have UBTI under § 512(a)(3)(B), if it had gross income derived from any unrelated trade or business regularly carried on by the VEBA as if the organization were subject to

The agreement also provides that the LPs are not permitted to make additional contributions in-kind to X unless permitted by the Adviser, as general partner, and subject to applicable law.

X represents that contributions of securities to X from its Partners in exchange for limited partnership interests therein were non-recognition exchanges under § 721(a) and that § 721(b) did not apply to any such contribution because each Plan contributed a portfolio of assets that was “diversified” within the meaning of § 1.351-1(c)(6)(i).

X’s agreement was drafted with the intent to comply with §§ 704(b) and 704(c). The Agreement requires that a separate capital account be established and maintained for each partner in accordance with the capital account maintenance rules of § 1.704-1(b)(2)(iv). The agreement requires that on liquidation of X (or any limited partner's interest in X), liquidating distributions are to be made in accordance with the capital account balances of the partners. The agreement also contains a qualified income offset, as defined by § 1.704-1(b)(2)(ii)(d). Except as required by § 704(c), items of profit or loss are allocated in accordance with the partners' relative capital account balances.

Additionally, the agreement provides that the capital accounts of the partners will be increased or decreased to reflect a revaluation of the property of X on X’s books upon the occurrence of a revaluation event. X will make revaluations at least annually in accordance with § 1.704-3(e)(3)(iii)(B)(2)(ii). Revaluation events include:

(a) A contribution of money or other property (other than a de minimis amount) to X by a new or existing partner as consideration for an interest in X;

(b) The liquidation of X or a distribution of money or other property (other than a de minimis amount) by X to a retiring or continuing partner as consideration for an interest in X; and

(c) The end of each quarter in accordance with generally accepted industry accounting practices.

Further, X represents that it qualifies as a "securities partnership" as defined in § 1.704-3(e)(3)(iii). The stock contributed to X is actively traded within the meaning of § 1.1092(d)-1. For purposes of making reverse § 704(c) allocations, X will adopt the full netting approach as described in § 1.704-3(e)(3)(iv). All § 704(c) and reverse § 704(c) allocations made under the full netting approach will at all times comply with § 1.704-3(e)(3)(v). X will consistently apply the same aggregate approach to all of its qualified financial assets for all taxable years in which X qualifies as a securities partnership.

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§ 512(a)(1). We are relying on the representations provided by X that LP1 does not have such income attributable to assets contributed to X and we are not ruling on this issue.

The full netting approach adopted by X will preserve the tax attributes of each item of gain or loss realized by X.

Finally, X represents that contributions or revaluations of property and the corresponding allocations of tax items by X will not be made with a view to shifting the tax consequences of built-in gain or built-in loss among the partners in a manner that would substantially reduce the present value of the partners' aggregate tax liability.

X requests the following rulings:

(1) X's use of the full netting approach method, as provided by § 1.704-3(e)(3)(v), for aggregating built-in gains and built-in losses from qualified financial assets for purposes of making reverse § 704(c) allocations is reasonable within the meaning of § 1.704-3(e)(3).

(2) X has permission to aggregate built-in gains and built-in losses from qualified financial assets contributed to X by the Partners with built-in gains and built-in losses from revaluations of qualified financial assets held by X for purposes of making § 704(c) and reverse § 704(c) allocations.

Ruling # 1

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 into account 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) of the Income Tax Regulations provides 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 deduction 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 § 704(c).

Section 1.704-3(a)(2) provides 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) provides 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 purpose of § 704(c). Once a partnership adopts an aggregate approach, that 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) provides that a partnership is a securities partnership if the partnership is either a management company or an investment partnership, and the partnership makes all of its book allocations in proportion to the partners' relative book capital accounts (except for reasonable special allocations to a partner that provides management services or investment advisory services to the partnership). Under § 1.704-3(e)(3)(iii)(B)(2), a partnership is an investment partnership if (i) on the date of each capital account restatement, the partnership holds qualified financial assets that constitute at least 90 percent of the fair market value of the partnership's non-cash assets, and (ii) the partnership reasonably expects, as of the end of the first taxable year in which the partnership adopts an aggregate approach under § 1.704-3(e)(3), to make revaluations at least annually.

Section 1.704-3(e)(3)(ii) provides that a qualified financial asset is any personal property (including stock) that is actively traded. Actively traded means actively traded as defined in § 1.1092(d)-1 (defining actively traded property for purposes of the straddle rules).

Section 1.704-3(e)(3)(iv) and § 1.704-3(e)(3)(v) provide 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(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 § 1.704-3(e)(3) must (1) preserve the tax attributes of each item of gain or loss realized by the partnership, (2) be determined under an approach that is consistently applied, and (3) not be determined with a view to reducing substantially the present value of the partners' aggregate tax liability.

X has elected to use the full netting method for making reverse § 704(c) allocations as described in § 1.704-3(e)(3)(v). Section 1.704-3(e)(3)(v) 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 book gains and losses and determining 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.

After applying the relevant law to the information and representations submitted, we rule that X's method of making reverse § 704(c) allocations is a reasonable method within the meaning of § 1.704-3(e)(3), 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 partnership in a manner that substantially reduces the present value of the partners' aggregate tax liability.

Ruling # 2

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 pre-contribution built-in gains and losses 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 private 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 Rev. Proc. 2001-36, 2001-1 C.B. 1326, the Service granted automatic permission for certain securities partnerships to aggregate contributed property for purposes of making § 704(c) allocations. Rev. Proc. 2001-36 also described the information that must be included with the ruling requests for permission to aggregate contributed property for purposes of making § 704(c) allocations submitted by partnerships that do not qualify for automatic permission.

In this case, X represents that the burden to X of making § 704(c) allocations separate from reverse § 704(c) allocations is substantial. X will use the full netting approach described in § 1.704-3(e)(3)(v) for making forward and reverse § 704(c) allocations. The likelihood that X and its partners could abuse this type of aggregation is minimal.

After applying the relevant law to the information submitted and representations made, we rule that X's method of making § 704(c) allocations, including reverse allocations, for its partners is a reasonable method within the meaning of § 1.704-3(a)(1), and is permissible under § 1.704-3(e)(4)(iii), provided that a contribution or revaluation of the 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.

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.

This ruling is 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 allocations of items other than items of gain or loss from the sale or other disposition of qualified financial assets, or the aggregation of built-in gains and losses from qualified financial assets contributed to X by any partner other than the partners described in this ruling. X must maintain sufficient records to enable it and its partners to comply with §§ 704(c)(1)(b) and 737.

Additionally, this ruling applies only to the contributions to X by the Partners for whom X supplied specific information concerning the contributed assets as described above, and not to any other contributions by the partners or any other future partner.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representatives.

Sincerely,

Melissa C. Liquerman
Branch Chief, Branch 2
(Passthroughs & Special Industries`)

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