Internal Revenue Service

Department of the Treasury

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LEGEND

A =

B =

C =

State =

Country =

Dear

This letter responds to a letter, dated June 10, 1999, and subsequent correspondence by your authorized representative on behalf of A, requesting a ruling concerning the federal income tax consequences of the contribution of property to a partnership.

FACTS

According to the information submitted, A is a State limited partnership formed for the purpose of making investments in various stocks and securities. A's portfolio includes common and preferred equity, warrants, options, commercial paper, government debt, and corporate securities. B is a Country corporation formed for a similar purpose and has a similar portfolio of assets.

To simplify the negotiation and execution of investments and dispositions of stocks and securities, and to lower investment costs, A and B propose to form a new partnership, C, and transfer their respective portfolios to it in exchange for proportionate interests in the partnership. Additionally, it is anticipated that in the future, C will raise additional capital in the form of cash.

A has represented that:

1. A and B will contribute solely cash and/or a diversified portfolio of stocks and securities to C.

2. There is no plan or intention for A or B to transfer assets other than cash and/or a diversified portfolio of stocks and securities to C.

3. Any other transferor who has contributed or will contribute assets to C has contributed or will contribute solely cash and/or a diversified portfolio of stocks and securities to C.

For the purposes of these representations, a portfolio of stocks and securities is diversified if it satisfies the 25 and 50 percent tests of § 368(a)(2)(F)(ii) of the Internal Revenue Code, applying the relevant provisions of § 368(a)(2)(F), except that in applying § 368(a)(2)(F)(iv), government securities are included in determining total assets unless the government securities are acquired to meet the requirements of § 368(a)(2)(F)(ii).

LAW AND ANALYSIS

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property in exchange for an interest in the partnership.

Section 721(b) provides that § 721(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 1.351-1(c)(1) of the Income Tax Regulations 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 and 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. 105-33, 105th Cong., 1st Sess. 131 (1997); H. R.

Rep. 105-148, 105th Cong., 1st Sess. 447 (1997); H. R. Rep. 105-220, 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 (i) 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 (ii) 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 the 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 tests), but are not treated as securities of an issuer for purposes of the numerator of the 25 and 50 percent tests.

A corporation is diversified within the meaning of § 368(a)(2)(F)(ii) if not more than 25 percent of the value of its total 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 5 or fewer issuers.

CONCLUSIONS

After applying the relevant law to the facts submitted and the representations made, we find that the transfer by A to C is not a transfer of property to a partnership that would be treated as an investment company (within the meaning of § 351) if C were incorporated, provided that this is the only transfer to C (except for transfers solely of cash and/or a diversified portfolio of stocks and securities). Accordingly, no gain or loss will be recognized by A on contribution of the assets described above to C, in exchange for an interest in C.

We express no opinion on the tax treatment of the transaction described above under any other provision of the Code or regulations or the tax treatment of any conditions existing at the time or, or effects resulting from, the transaction not specifically covered by the above ruling. In particular, we express no opinion as to whether the proposed transaction described above is part of a plan to achieve diversification without recognition of gain under § 1.351-1(c)(5). Furthermore, we express no opinion as to the consequences of other transfers to C, either as to whether such other transfers would be "transfers to an investment company" or would (except
for transfers solely of cash and/or a diversified portfolio of stocks and securities), when taken together with the transfers by A and B, cause those transfers to be considered

"transfers to an investment company."

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling will be modified or revoked if adopted temporary or final regulations are inconsistent with any conclusions in this ruling. See, § 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6. However, when the criteria in § 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Under a power of attorney on file in this office, copies of this letter are being sent to your authorized representatives.

This ruling is directed only to the taxpayer requesting it. Under § 6110(k)(3), it may not be used or cited as precedent.

Sincerely yours,

Jeff Erickson
Assistant to the Branch Chief,
Branch 3
Office of the Assistant Chief
Counsel
(Passthroughs and Special
Industries)

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