Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200049031**
Release Date: 12/8/2000
Index Number: 721.00-00, 351.00-00, 731.00-00

Person to Contact:

Telephone Number:

Refer Reply To:
PLR-104936-00 / CC:PSI:3
Date:
September 11, 2000

LEGEND

Fund 1 =

Fund 2 =

Fund 3 =

Fund 4 =

Fund 5 =

Fund 6 =

D1 =

D2 =

D3 =

D4 =

D5 =

Manager =

State =

Dear

This letter responds to your February 18, 2000, letter, and subsequent correspondence on behalf of Fund 4, requesting certain rulings under the Internal Revenue Code.

FACTS

According to the information submitted, Fund 1 (formed on D1), Fund 2 (formed on D2), Fund 3 (formed on D3), and Fund 4 (formed on D4) (collectively "the Funds") are separate master fund portfolios in a "master-feeder" investment structure. The Funds are series of registered investment companies sponsored by Manager. Specifically, Fund 1, Fund 2, and Fund 3 are subtrusts of Fund 5, and Fund 4 is a subtrust of Fund 6. Fund 5 and Fund 6 are trusts organized under State law and are open-end management investment companies under the Investment Company Act of 1940 (the 1940 Act). Fund 4 has substantially the same investment objective as Fund 2.

Investments in Fund 5 and Fund 6 may only be made by certain institutional investors such as regulated investment companies (RICs) and segregated asset accounts. Generally, no individual, S corporation, partnership, or grantor trust beneficially owned to any extent by an individual, S corporation, or partnership may invest in any portfolio of Fund 5 or Fund 6. The interest of the holders in any portfolio or series is limited to the net assets of that portfolio or series and does not extend to the assets of any other investment vehicles of Fund 5 or Fund 6.

A portfolio interest entitles the holder to receive a pro rata share of distributions of income and capital gain and an allocable share of any losses the portfolio experiences. Holders' capital accounts are maintained by the portfolio, and any increases or decreases in a holder's investment are made by adjusting the capital account balance. The allocations of taxable income, gain, loss, deductions and credits under each agreement transferring a beneficial interest have been drafted with the intent to comply with the regulations promulgated under §§ 704(b) and (c) of the Internal Revenue Code. Each holder is entitled to a pro rata share, in proportion to its capital account, of the assets of a separate portfolio upon its liquidation and may only look to the assets of the separate portfolio on liquidation, redemption, or termination of the separate portfolio.

On D5, Fund 1 contributed all of its assets to Fund 3 and Fund 4 (the Fund 1 Contributions) and Fund 2 contributed all of its assets to Fund 4 (the Fund 2 Contribution) (collectively the Contributions), in exchange for interests in those funds. Thereafter, both Fund 1 and Fund 2 liquidated, distributing the interests in Fund 3 and Fund 4 they received to their feeder funds in complete redemption of the interests in Fund 1 and Fund 2 held by those funds. The purpose of these Contributions was to consolidate the assets of what were four master funds with substantially similar investment objectives, into two master funds, i.e. Fund 3 and Fund 4, thereby eliminating duplicative expenses and achieving economies of scale. Based upon the Funds' respective sizes, the Contributions and related distributions caused a technical termination of Fund 4.

With regard to its Contributions, Fund 1 and Fund 2 represent that they contributed to Fund 4, and Fund 4 represents that it held immediately after the

Contributions, a diversified portfolio of stocks and securities. For purposes of this representation, a portfolio of stocks and securities is diversified if it satisfies § 368(a)(2)(F)(ii), 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 § 368(a)(2)(F)(ii).

The Funds also represent that none of their respective investors acquired their interests in any of the Funds in exchange for any asset other than cash or other permissible investments of "investment partnerships" within the meaning of § 731(c)(3)(C)(i).

RULINGS REQUESTED

Fund 4 requests rulings that :

1) Fund 4 will not recognize any gain or loss as a result of the Contributions. Specifically, Fund 4 requests a ruling that it is not an "investment company" as defined by § 721(b) and § 351(d). If the Contributions qualify as nonrecognition transactions under § 721, Fund 4 requests that its bases and holding periods in its new properties be determined accordingly.

2) Neither Fund 4, Fund 1, nor Fund 2 will recognize gain or loss on the technical termination of Fund 4.

DISCUSSION

1.a. Pursuant to § 721, no gain or loss shall be recognized to Fund 4 as a result of the Contributions.

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. 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) 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 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. 105- 33, 105th Cong., 1st Sess. 131 (1997); H.R. Rep. No. 105-148, 105th Cong., 1st Sess., 447 (1997); H.R. Rep. No. 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. Rev. Rul. 87-9, 1987-1 C.B. 133, provides that a transfer to a corporation of shares of corporation Y stock by one transferor, and a transfer of cash by another transferor will be treated as a transfer of nonidentical assets under § 1.351-1(c).

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 investment in the stock and securities of five or fewer issuers.

After applying the relevant law to the facts submitted and the representations made, we conclude that the respective transfers of property by Fund 1 and Fund 2 to Fund 4 would not be transfers to an investment company within the meaning of § 351 and § 1.351-1(c) if Fund 4 was incorporated, provided that these are the only transfers to Fund 4. Therefore, under § 721, no gain or loss shall be recognized by Fund 4.

1.b. Fund 4' s basis and holding period in its new property shall be determined accordingly.

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 1223(2) provides that in determining the period for which the taxpayer has held property however acquired there shall be included in the period for which such property was held by any other person, if under this chapter such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

Based on the findings that no gain or loss was recognized on the Contributions, Fund 4 will have a basis in any property received from Fund 1 and Fund 2 equal to the adjusted basis (determined immediately prior to the Contributions to Fund 4) of such property to Fund 1 and Fund 2. Also, Fund 4 will have, in the case of any such property that is a capital asset, a holding period for such property which includes Fund 1's and Fund 2's holding period for such property.

2. Neither Fund 4, Fund 1, nor Fund 2 will recognize gain or loss on the technical termination of Fund 4.

Section 708(a) provides that for the purposes of subchapter K, an existing partnership shall be considered as continuing if it is not terminated.

Section 708(b)(1)(B) provides that for the purposes of § 708(a), a partnership shall be considered as terminated only if within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in the partnership capital and profits.

Section 761(e)(1) provides that except as otherwise provided in regulations, for purposes of § 708 (relating to continuation of a partnership), any distribution of an interest in a partnership (not otherwise treated as an exchange) shall be treated as an exchange.

Based on the relative sizes of Fund 1 and Fund 2 compared to Fund 4, the Contributions along with the related distributions, resulted in the sale or exchange of more than 50 percent of the total interest in Fund 4's capital and profits, and a partnership termination under § 708(b)(1)(B).

Section 1.708-1(b)(1)(iv) provides, in part, that if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership for the continuation of the business by the new partnership.

After applying the relevant law to the facts presented and the representations made, we conclude that neither Fund 4, Fund 1, nor Fund 2 will recognize any gain or loss under § 721 as a result of the deemed transactions under § 1.708-1(b)(1)(iv).

CONCLUSIONS

As stated above, after applying the relevant law to the facts submitted and the representations made, we find that Fund 4 will be treated as a continuing partnership, and that it will not recognize gain or loss as result of the Contributions and the related distributions. Furthermore, the bases and holding periods of all of the assets involved to Fund 4 will be determined under §§ 722, 723, 732(b), 735(b) and 1223, as applicable. In addition, neither Fund 4, Fund 1, nor Fund 2 will recognize any gain or loss under § 721 due to the technical termination of Fund 4 under § 708(b)(1)(B).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express no opinion about whether subsequent transfers of property to Fund 4 by any transferor would be considered to be part of the original transfers, thereby potentially affecting the tax consequences of the original transfers. Additionally, we express no opinion about whether the above-referenced transfers are part of a plan to achieve diversification without recognition of gain under § 1.351-1(c)(5).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of

the material submitted in support of the request for rulings, it is subject to verification on examination.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to the taxpayer.

This ruling is directed only to the taxpayer requesting it, Fund 4. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely Yours,
Robert Honigman
Acting Assistant to the Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)