Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:PSI:B03 - PLR-144594-02
Date:
April 10, 2003

P =

X =

State W =

State Y =

z =

Dear :

We received your letter dated August 9, 2002, and subsequent correspondence, submitted on behalf of P by P's authorized representatives, requesting certain rulings under §§ 752 and 465 of the Internal Revenue Code regarding P's proposal to issue unsecured debt to refinance certain outstanding debt obligations. This replies to your request.

The information provided indicates that P is a State W limited partnership. X, a State Y real estate investment trust, is the managing general partner of P. X owns approximately z percent of the units of P. A portion of the remaining units are owned by individuals subject to § 465. P primarily acquires, owns and operates commercial properties, directly and through subsidiary partnerships (including limited liability companies). The aggregate gross fair market value of the property owned by P that is neither real property nor property incidental to the activity of holding real property will be less than 10 percent of the aggregate gross fair market value of all assets of P (including assets held through subsidiary partnerships).

P owns properties subject to secured nonrecourse debt. In addition, P has issued and anticipates that it will continue to issue unsecured debt that is not recourse to any partner of P or a subsidiary, related person, or any of the assets of any partner or related person. It is possible that in the future certain partners of P may agree to issue guarantees or deficit restoration obligations with respect to a portion of this unsecured debt. The portion of the debt that is not subject to any guarantees or affected by any deficit restoration obligations is referred to herein as the "Unsecured Debt." The Unsecured Debt will be a general obligation of P, such that, in the case of a default, the holders of the Unsecured Debt will have a claim against all of the assets of P, rather than against specific assets of P.

It is anticipated that the Unsecured Debt will be issued to refinance the mortgage debt taken subject to by P in connection with the acquisitions of properties (or mortgage debt that was later incurred to refinance mortgage debt that was taken subject to by P at the time of acquisition). P owns these properties either directly or through subsidiary partnerships (including limited liability companies) in which it owns substantially all of the economic interests and controls the general partner (or is, or controls, the managing member). It is also anticipated that the Unsecured Debt will be used to fund acquisition and development activity of P.

P represents that the Unsecured Debt will provide that none of the partners of P and no related person to any partner (as defined in § 1.752-4(b)) will have any liability for the repayment of the Unsecured Debt.

P also has available an unsecured line of credit. P is able to draw upon the line of credit from time to time to obtain capital to meet its various needs subject to continued compliance with certain financial and other covenants. The line of credit is a general obligation of P.

P anticipates drawing advances under the line of credit that will be applied to refinance mortgage debt taken subject to by P in connection with the acquisition of properties (or mortgage debt that was later incurred to refinance mortgage debt that was taken subject to by P at the time of acquisition). The line of credit also is used currently to fund other acquisition and development activity of P.

Under the line of credit, as it is currently in effect, the lenders would have recourse against X in the event that a default under the line of credit were to occur. P and X intend to pursue an amendment of the line of credit so that neither X nor any of the partners of P have any personal liability for repayment of the line of credit. Therefore, the liabilities will become nonrecourse to the partners of P. It is possible, however, that in the future certain partners of P may agree to issue guarantees or deficit restoration obligations with respect to a portion of the line of credit. The portion of the line of credit that is not subject to any guarantees or affected by any deficit restoration obligations is referred to herein as the "Line of Credit."

P intends to allocate the Unsecured Debt and the advances under the Line of Credit first to the properties that were acquired with or had their existing mortgage debt repaid by the proceeds of the Unsecured Debt and the advances under the Line of Credit (to the extent of such proceeds), and then in accordance with the net fair market value of each property (the “Proposed Method”).

P represents that neither the Unsecured Debt nor the Line of Credit will be convertible into an equity interest in P.

P further represents that to the best of its knowledge the purchasers of the Unsecured Debt will be qualified purchasers that satisfy the requirements of § 49(a)(1)(D)(iv).

P also represents that each of the lenders of the Line of Credit is a qualified person within the meaning of § 49(a)(1)(D)(iv).

Section 752(a) provides that any increase in a partner's share of liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by the partner of partnership liabilities is considered a contribution of money by the partner to the partnership. Similarly, under § 752(b), any decrease in a partner's share of liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of the individual liabilities is considered a distribution of money to the partner by the partnership.

Section 752(c) provides that, for purposes of § 752, a liability to which property is subject will, to the extent of the fair market value of such property, be considered as a liability of the owner of the property.

Section 1.752-1(a)(1) of the Income Tax Regulations provides that a partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss for that liability under § 1.752-2.

Section 1.752-2(b)(1) provides that except as otherwise provided in § 1.752-2(b), a partner bears the economic risk of loss for a partnership liability to the extent that, if the partnership constructively liquidated, the partner or related person would be obligated to make a payment to any person (or a contribution to the partnership) because that liability becomes due and payable and the partner or related person would not be entitled to reimbursement from another partner or person that is a related person to another partner.

Section 1.752-2(b)(3) provides that the determination of the extent to which a partner or related person has an obligation to make a payment under § 1.752-2(b)(1) is based on the facts and circumstances at the time of the determination. All statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying § 1.752-2, including contractual obligations outside the partnership agreement such as guarantees, indemnifications, reimbursement agreements, and other obligations running directly to creditors or to other partners, or to the partnership; obligations to the partnership that are imposed by the partnership agreement, including the obligation to make a capital contribution and to restore a deficit capital account upon liquidation of the partnership; and payment obligations (whether in the form of direct remittances to another partner or a contribution to the partnership) imposed by state law, including the governing state partnership statute.

Section 1.752-3(a) provides that a partner's share of the nonrecourse liabilities of a partnership equals the sum of the following:

(1) The partner's share of partnership minimum gain determined in accordance with the rules of § 704(b) and the regulations thereunder;

(2) The amount of any taxable gain that would be allocated to the partner under § 704(c) (or in the same manner as § 704(c) in connection with a revaluation of partnership property) if the partnership disposed of (in a taxable transaction) all partnership property subject to one or more nonrecourse liabilities of the partnership in full satisfaction of the liabilities and for no other consideration; and

(3) The partner's share of the excess nonrecourse liabilities (those not allocated under § 1.752-3(a)(1) and (2)) of the partnership as determined in accordance with the partner's share of partnership profits. The partner's interest in partnership profits is determined by taking into account all facts and circumstances relating to the economic arrangement of the partners. The partnership agreement may specify the partners' interests in partnership profits for purposes of allocating excess nonrecourse liabilities provided the interests so specified are reasonably consistent with allocations (that have substantial economic effect under the § 704(b) regulations) of some other significant item of partnership income or gain. Alternatively, excess nonrecourse liabilities may be allocated among the partners in accordance with the manner in which it is reasonably expected that the deductions attributable to those nonrecourse liabilities will be allocated. Additionally, the partnership may first allocate an excess nonrecourse liability to a partner up to the amount of built-in gain that is allocable to the partner on § 704(c) property (as defined under § 1.704-3(a)(3)(ii)) or property for which reverse § 704(c) allocations are applicable (as described in § 1.704-3(a)(6)(i)) where such property is subject to the nonrecourse liability to the extent that such built-in gain exceeds the gain described in § 1.752-3(a)(2) with respect to such property. This additional method does not apply for purposes of § 1.707-5(a)(2)(ii). To the extent that a partnership uses this additional method and the entire amount of the excess nonrecourse liability is not allocated to the contributing partner, the partnership must allocate the remaining amount of the excess nonrecourse liability under one of the other methods in § 1.752-3(a)(3). Excess nonrecourse liabilities are not required to be allocated under the same method each year.

In § 1.752-3(a)(2), the amount of taxable gain a partner is allocated is referred to as § 704(c) minimum gain. Section 704(c) minimum gain is the amount of gain that a partner would receive under § 704(c) from a hypothetical sale solely in satisfaction of the nonrecourse liabilities encumbering partnership property. With limited exceptions (see § 1.704- 3(e)(2)), § 704(c) minimum gain is calculated on a property-by-property basis. If more than one item of partnership property is subject to a single nonrecourse liability, the partnership must allocate the nonrecourse liability among the individual items of partnership property before the partnership can calculate each partner's share of § 704(c) minimum gain.

Section 1.752-3(b)(1) provides that for purposes of determining the amount of taxable gain under § 1.752-3(a)(2), if a partnership holds multiple properties subject to a single nonrecourse liability, the partnership may allocate the liability among the multiple properties under any reasonable method. A method is not reasonable if it allocates to any item of property an amount of the liability that, when combined with any other liabilities allocated to the property, is in excess of the fair market value of the property at the time the liability is incurred. The portion of the nonrecourse liability allocated to each item of partnership property is then treated as a separate loan under § 1.752-3(a)(2). In general, a partnership may not change the method of allocating a single nonrecourse liability under § 1.752-3(b) while any portion of the liability is outstanding. However, if one or more of the multiple properties subject to the liability is no longer subject to the liability, the portion of the liability allocated to that property must be reallocated among the properties still subject to the liability so that the amount of the liability allocated to any property does not exceed the fair market value of such property at the time of reallocation.

Section 1.752-3(b)(2) provides that for purposes of § 1.752-3(b), when the outstanding principal of a partnership liability is reduced, the reduction of outstanding principal is allocated among the multiple properties in the same proportion that the partnership liability originally was allocated to the properties under § 1.752-3(b)(1).

Section 465 limits the deductions for losses for any taxable year for an activity to the extent of the total amount for which the taxpayer is at risk for the activity at the close of the taxable year. For partnerships, the § 465 at risk limitation applies at the partner level.

Under § 465(c)(3), the activity engaged in by the taxpayer in carrying on a trade or business of holding real property is subject to the at risk limitation of § 465.

Section 465(b)(2)(A) provides that a taxpayer's at risk amount includes amounts borrowed for use in an activity to the extent that the taxpayer is personally liable for the repayment of the borrowed amounts. Section 465(b)(6), however, allows a taxpayer to treat qualified nonrecourse financing as an amount at risk even though the taxpayer is not personally liable for the repayment of the financing. Section 465(b)(6)(A) provides that notwithstanding any other provision of § 465(b), in the case of an activity of holding real property, a taxpayer is considered at risk for the taxpayer's share of any "qualified nonrecourse financing" that is secured by real property used in the activity of holding real property.

Section 465(b)(6)(B) defines qualified nonrecourse financing to mean any financing (i) that is borrowed by the taxpayer for the activity of holding real property, (ii) that is borrowed by the taxpayer from a qualified person or represents a loan from any federal, state, or local government or instrumentality thereof, or is guaranteed by any federal, state, or local government, (iii) except to the extent provided in regulations, for which no person is personally liable for repayment, and (iv) that is not convertible debt.

Section 465(b)(6)(C) provides that in the case of a partnership, a partner's share of any qualified nonrecourse financing of such partnership shall be determined on the basis of the partner's share of liabilities of such partnership incurred in connection with such financing (within the meaning of § 752).

Section 1.465-27(b)(2)(i) provides that for a taxpayer to be considered at risk under § 465(b)(6), qualified nonrecourse financing must be secured only by real property used in the activity of holding real property. For this purpose, however, property that is incidental to the activity of holding real property will be disregarded. In addition, for this purpose, property that is neither real property used in the activity of holding real property nor incidental property will be disregarded if the aggregate gross fair market value of such property is less than 10 percent of the aggregate gross fair market value of all the property securing the financing. Section 1.465-27(b)2)(ii) provides that for purposes of § 1.465-27(b)(2)(i), a borrower shall be treated as owning directly its proportional share of the assets in a partnership in which the borrower owns (directly or indirectly through a chain of partnerships) an equity interest.

Section 1.465-27(b)(4) provides that the personal liability of any partnership for repayment of a financing is disregarded and the financing is treated as qualified nonrecourse financing secured by real property if (i) the only persons personally liable to repay the financing are partnerships; (ii) each partnership with personal liability holds only property described in § 1.465-27(b)(2)(i); and (iii) in exercising its remedies to collect on the financing in a default or default-like situation, the lender may proceed only against property that is described in § 1.465- 27(b)(2)(i) and that is held by the partnership or partnerships. Section 1.465-27(b)(5) provides that principles similar to those found in § 1.465-27(b)(4) apply in determining whether a financing of an entity disregarded for federal tax purposes is treated as qualified nonrecourse financing secured by real property.

Based on the information provided and the representations made, we conclude as follows:

1. For purposes of § 752 and § 1.752-3(a)(2), P may allocate the Unsecured Debt and each advance under the Line of Credit among its multiple properties (including P's proportional share of the properties owned by P's subsidiaries that qualify as partnerships for federal tax purposes) under the Proposed Method or any other reasonable method; provided, however, that the aggregate allocation of the Unsecured Debt and the outstanding advances under the Line of Credit to each property, when

combined with any other liabilities allocated to the property, may not exceed the fair market value of the property at the time the liabilities are incurred.

2. For purposes of § 1.752-3(a)(2), the Unsecured Debt and the outstanding advances under the Line of Credit will be treated as nonrecourse liabilities secured by P's assets (including P's proportional share of the properties owned by P's subsidiaries that qualify as partnerships for federal tax purposes).

3. For purposes of § 752, P must allocate reductions in the amount of the Unsecured Debt among its multiple properties (including P's proportional share of the properties owned by P's subsidiaries that qualify as partnerships for federal tax purposes) in the same manner and in the same proportion as the Unsecured Debt is initially allocated.

4. For purposes of § 752 and § 1.752-3, P may designate each advance under the Line of Credit as a separate loan (with all advances on a particular date treated as a single advance for this purpose) and may designate repayments under the Line of Credit as repayments of one or more specified advances thereunder, with reductions in each advance under the Line of Credit allocated among P's multiple properties (including P's proportional share of the properties owned by P's subsidiaries that qualify as partnerships for federal tax purposes) in the same manner and in the same proportion as such advance is initially allocated.

5. Pursuant to § 1.752-3(a)(3), the excess nonrecourse liabilities with respect to the Unsecured Debt and the advances under the Line of Credit may be allocated based on the partners' excess § 704(c) gain with respect to any of P's assets (including P's proportional share of the properties owned by P's subsidiaries that qualify as partnerships for federal tax purposes) not taken into account under § 1.752-3(a)(2).

6. For purposes of § 465(b)(6)(A), the Unsecured Debt and the outstanding advances under the Line of Credit will be treated as qualified nonrecourse financing as to which no person has personal liability and that is considered secured by P's assets (including P's proportional share of the properties owned by P's subsidiaries that qualify as partnerships for federal tax purposes).

Except as specifically ruled upon above, we express or imply no opinion on the federal tax consequences of the transactions described above under any other provisions of the Code, including whether the Line of Credit, as amended, or the Unsecured Debt will be treated as nonrecourse liabilities. The rulings set forth above regarding the use of the proceeds from the advances under the Line of Credit are conditioned on the amendment of the Line of Credit resulting in neither X nor any of the partners of P having any liability for repayment of the Line of Credit. Similarly, the rulings regarding the Unsecured Debt are conditioned on the representation that neither X nor any of the partners of P will have any personal liability for the repayment of the Unsecured Debt. Furthermore, we express or imply no opinion regarding the tax consequences of the conversion of the Line of Credit from a recourse liability to a nonrecourse liability.

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

Pursuant to the power of attorney on file with this office, copies of this letter are being sent to P's authorized representatives.

Sincerely yours,

CHRISTINE ELLISON
Chief, Branch 3
Office of the Associate
Chief Counsel
(Passthroughs and Special
Industries)

Enclosures: 2
Copy of this letter
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cc: