Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:INTL:B05
PLR-138831-07

Date:
February 22, 2008

Parent =

Subsidiary 1 =

Subsidiary 2 =

State A =
Foreign Countries =
Currency 1 =
Currency 2 =

Dear :

This is in response to your letter dated August 15, 2007 in which you request a ruling under Treas. Reg. § 1.985-1(b)(1)(iii) that Subsidiary 1 and Subsidiary 2 (each a "Subsidiary" and together the "Subsidiaries") may each use a currency other than the U.S. dollar as its functional currency. Specifically, you request a ruling that permits the Subsidiaries to determine their functional currencies by applying the principles used to determine the functional currency of a qualified business unit (a "QBU") that is not required to use the dollar as set forth in Treas. Reg. § 1.985-1(c).

The ruling contained in this letter is predicated upon facts and representations submitted by Parent and accompanied by a penalties of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of factual information, representations

and other data may be required as part of the audit process. Parent has represented the facts described below.

FACTS:

The Subsidiaries are direct subsidiaries of Parent. Parent and Subsidiaries are each State A corporations and each intend to qualify as real estate investment trusts ("REITs") under Subchapter M of the Internal Revenue Code.

Parent formed Subsidiaries to acquire and own loans that are denominated in currencies other than the U.S. dollar from obligors located in the Foreign Countries and to acquire and own real estate located outside the U.S. that will be leased to third party tenants. Parent intends to cause the Subsidiaries to finance the acquisition and ownership of these foreign obligations and foreign assets through non-U.S. dollar denominated borrowings.

Each of the Subsidiaries will operate its business in the currency of the foreign assets it owns and foreign obligations it incurs. In particular, Subsidiary 1 will operate its business in Currency 1 and Subsidiary 2 will operate its business in Currency 2. The gross income of each of the Subsidiaries is expected to consist principally of interest from the foreign loans and rents from the foreign assets. Each of the Subsidiaries will conduct its activities, including acquiring and owning foreign assets and incurring foreign obligations, and maintaining its books and records, in its designated currency.

LAW:

In general, section 985 provides that all determinations for Federal income tax purposes shall be made in the taxpayer's functional currency. Section 985(a). Treas. Reg. § 1.985-1(b)(1)(iii) provides that except as otherwise provided by ruling or administrative pronouncement, the U.S. dollar shall be the functional currency of a QBU that has the United States as its residence as defined in section 988(a)(3)(B). Treas. Reg. § 1.989(a)-1(b)(2)(i) provides that a corporation is a QBU. Section 988(a)(3)(B)(i)(II) provides that the United States shall be the residence of a corporation which is a United States person. Section 7701(a)(30) provides, in part, that the term "United States person" means a domestic corporation. Section 7701(a)(4) provides that the term "domestic," as applied to a corporation, means created or organized in the United States or under the law of the United States or any State. See also Treas. Reg. § 1.988-4(d)(1)(ii).

Treas. Reg. § 1.985-1(c)(1) provides that if a QBU is not required to use the dollar as its functional currency, then its functional currency shall be the currency of the economic environment in which a significant part of the QBU's activities is conducted, if the QBU keeps, or is presumed to keep, its books and records in such currency. Treas. Reg. § 1.985-1(c)(2) provides that the economic environment in which a significant part of the

QBU's activities is conducted shall be determined by taking into account all the facts and circumstances. Treas. Reg. § 1.985-1(c)(2)(i) sets forth some facts and circumstances that are considered when determining the economic environment in which a significant part of the QBU's activities is conducted.

The General Explanation of the Tax Reform Act of 1986 states that "[i]n appropriate circumstances, a domestic QBU (such as a regulated investment company organized to invest in securities denominated in a specific currency) may have a foreign currency as the functional currency." Staff of the Joint Committee on Taxation, 100th Cong., 1st Sess., General Explanation of the Tax Reform Act of 1986, at 1093-94 (Comm. Print 1987).

ANALYSIS:

Absent a ruling to the contrary, each Subsidiary's functional currency would be the U.S. dollar because each Subsidiary is a U.S. corporation. Consequently, each Subsidiary would recognize foreign currency gain or loss on every section 988 transaction because such transactions would be denominated in a currency that would be non-functional currency to the Subsidiary. See section 988 and Treas. Reg. § 1.988-1(a). Moreover, any QBUs of the Subsidiaries with a currency other than the dollar as their functional currency would be subject to section 987.

In Rev. Rul. 2007-33, the Service ruled that foreign currency gains recognized by a REIT under section 988 are treated as qualifying income under sections 856(c)(2) and (3) to the extent the underlying income so qualifies. However, Rev. Rul. 2007-33 does not address foreign currency gains recognized under section 988 on a REIT's foreign obligations. Since foreign currency gains attributable to a REIT's foreign obligations are not expressly listed as qualifying income for purposes of sections 856(c)(2) and (3), a Subsidiary risks losing its REIT status if it is not permitted to adopt a non-U.S. functional currency by applying the principles of Treas. Reg. § 1.985-1(c).

If the ruling requested herein is issued, the functional currency of each Subsidiary would be determined by applying the principles of Treas. Reg. § 1.985-1(c). Under these principles, each Subsidiary would be eligible to adopt as its functional currency, the currency of the economic environment in which a significant part of the Subsidiary's activities is conducted. This conclusion is consistent with the language contained in the General Explanation of the Tax Reform Act of 1986 as set forth above.

Based solely on the facts and representations submitted, the principles of Treas. Reg. § 1.985-1(c)(2)(i) may be applied to determine the functional currency of each Subsidiary. If a Subsidiary properly adopts as its functional currency the currency of the economic environment in which a significant part of its activities is conducted, the Subsidiary will compute its taxable income or loss in that currency and translate its taxable income into dollars using the average exchange rate for the taxable year.

No opinion is expressed regarding the proper functional currency of either of the Subsidiaries under the principles of Treas. Reg. § 1.985-1(c).

No opinion is expressed whether Parent or either of its Subsidiaries qualifies as a REIT under section 856.

No opinion is expressed regarding the character of dividends or other REIT income distributed by Parent or either of its Subsidiaries to U.S. investors, or the character of income or loss realized on the sale by investors of their ownership interest in any of the REITs.

No opinion is expressed regarding the treatment of foreign currency received as dividends in the hands of the shareholders.

This 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.

It is important that a copy of this letter be attached to the Federal income tax return of the taxpayers involved for the taxable year in which the determination covered by this letter is made.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the representatives.

Sincerely,

Margaret K. Harris
Assistant to the Branch Chief, Branch 5
(International)