INTERNAL REVENUE SERVICE
Index No. 465.00-00; 752.00-00;
752.03-00; 752.07-00
Number: **199903017**
Release Date: 1/22/1999

CC:DOM:P&SI:1 PLR-111345-98

October 23, 1998

Legend

Partnership =

GP =

LP =

Authority =

$x =

y =

z% =

Date =

This letter responds to a letter dated July 9, 1998, together with prior correspondence, submitted on behalf of the Partnership, requesting rulings under §§ 752 and 465 of the Internal Revenue Code regarding the Partnership's incurrence of debt and its use of the debt proceeds to pay some of the Partnership's existing debt obligations.

Facts

The Partnership is engaged in the development and operation of apartment communities. GP is the general partner of the Partnership. LP is a limited partner of the Partnership. Partnership was formed by GP contributing cash and LP and their predecessor entities contributing assets, including properties subject to secured nonrecourse debt.

The Partnership has elected to use the traditional

allocation method under § 704(c) and § 1.704-3(b) of the Income Tax Regulations to account for the variation between the Partnership's basis in contributed property and the fair market value of the property at the time of contribution.

On Date, Authority issued certain bonds (the Bonds). Under the terms of a loan agreement between Authority and the Partnership (the Loan Agreement), the Bonds will be payable solely from, and secured by, payments to be made by the Partnership. The Bonds were issued under an indenture of trust (the Indenture) between Authority and the trustee named therein (the Trustee). Pursuant to the Indenture, Authority has assigned its right, title, and interest in the Loan Agreement to the Trustee for the benefit of the Bond owners. The Bonds are secured by the Partnership's pledge and assignment to make the loan payments under the Loan Agreement.

The Partnership's obligation to make payments under the Loan Agreement and the Bonds (the Financing) is a general obligation of the Partnership, and is not secured by any particular Partnership asset. The Financing is not recourse to any partner of the Partnership or related person (as defined in § 1.752-4(b)) and is not secured by any assets of any partner or related person.

The Partnership used the proceeds from the Financing to repay bonds with an aggregate principal amount of $x previously issued by Authority and secured by y separate mortgage loans on Partnership properties.

The Financing originally was issued to nationally recognized underwriters. The underwriters, however, immediately sold the Financing, but only to persons who, to the best knowledge of the Partnership, are "qualified persons" as defined in § 49(a)(1)(D)(iv) who are also either (i) "qualified institutional buyers" as defined in Rule 144A under the Securities Act of 1933, or (ii) "institutional accredited investors" as defined in Rule 501(a)(1), (2), (3), or (7) of the Securities Act of 1933 (the Initial Purchasers). Each Initial Purchaser acknowledged and represented that it:

1. Was purchasing an interest in the Financing for its own account or an account over which it exercises sole investment discretion and that it and any such account is a person which is a bank, savings & loan association, insurance company, or fund (including partnerships, trusts, mutual funds, long term bond funds, hedge funds, separate accounts and portfolio managers) that regularly purchases municipal revenue obligations, such as multifamily housing bonds, the ultimate obligor of which is a non-municipal entity, and either a "qualified institutional buyer" or "institutional accredited investor,"

2. Agreed that if it or such account resells or transfers its interest in the Financing before the second anniversary of the issuance of the Financing, such interest may be resold or transferred only to a person which is a bank, savings & loan association, insurance company, or fund (including partnerships, trusts, mutual funds, long term bond funds, hedge funds, separate accounts and portfolio managers) that regularly purchases municipal revenue obligations, such as multifamily housing bonds, the ultimate obligor of which is a non-municipal entity, and

3. Agreed that it will give each subsequent purchaser notice of any restrictions on the transfer of the Financing.

The Bonds bear a legend referring to these restrictions, and prior to the second anniversary of the issuance of the Financing, transfers of the Bonds will be prohibited unless the transferee acknowledges in writing that it is buying the Bonds for its own account or an account over which it exercises sole investment discretion and that it or such account is a bank, savings & loan association, insurance company, or fund (including partnerships, trusts, mutual funds, long term bond funds, hedge funds, separate accounts and portfolio managers) that regularly purchases municipal revenue obligations, such as multifamily housing bonds, the ultimate obligor of which is a non-municipal entity.

The Partnership represents that (1) the allocation of the Financing among its multiple properties at the time the Financing was incurred will be used throughout the time the Financing is outstanding, (2) to the best of its knowledge, the Initial Purchasers will be qualified persons as defined in § 49(a)(1)(D)(iv) prior to the second anniversary of the issuance of the Financing and, during that time period, substantially all of the benefits and burdens of ownership of the Financing will inure to persons who are qualified persons as defined in § 49(a)(1)(D)(iv), and (3) the Financing is not convertible into an equity interest in the Partnership.

The value of the Partnership's non-real property assets (Partnership's assets other than real property) is less than 20 percent of the value of all of its assets. The Partnership's non-real property assets are (1) personal property that is incidental to the activity of holding real property, (2) working capital, (3) deferred financing costs, and (4) a z% partnership interest in a property management company (the Service Business) that manages a portion of the Partnership's real properties. The Partnership will use its working capital that is not directly connected to providing space to its tenants to either repay existing debt or purchase additional investments in real property or personal property incidental thereto. The value of the Partnership's interest in the Service Business is less than five

percent of the value of all of its assets.

Rulings Requested

1. The Financing is treated as a nonrecourse liability under § 1.752-1(a)(2), and to the extent the creditor has a claim against the Partnership's property under state law if the Partnership defaults on the Financing, the Partnership's properties are treated as subject to the Financing under § 1.752-3(a)(2).

2. To calculate the § 704(c) minimum gain under § 1.752-3(a)(2), the Partnership may allocate the Financing among its various properties that are subject to the Financing in any amount that does not exceed the lesser of (i) the fair market value of the property or (ii) the amount of debt previously allocated to the property and repaid with proceeds from the Financing.

3. The Financing is treated as qualified nonrecourse financing under § 465(b)(6), and to the extent the creditor has a claim against the Partnership's properties under state law if the Partnership defaults on the Financing, the partners will be considered at risk for their shares of the Financing.

Law and Rulings

Section 752 Issues and Rulings

1. Nonrecourse liability

Section 1.752-1(a)(2) provides that a partnership liability is a nonrecourse liability under § 752 to the extent that no partner or related person bears the economic risk of loss under § 1.752-2. In this case, although the Financing is a general obligation of the Partnership, the creditors will have no claim against the partners in the Partnership or any related person (as defined in § 1.752-4(b)) or any such persons' assets if the Partnership defaults on the Financing. Thus, no partner or related person bears the economic risk of loss under § 1.752-2. Therefore, the Financing is a nonrecourse liability under § 752.

No specific Partnership property secures the Financing, but the creditors will have a claim against all of the Partnership's properties if the Partnership defaults on the Financing. We conclude, based solely on the facts submitted and the representations made, that the Partnership's properties are subject to the Financing under § 1.752-3(a)(2) to the extent a creditor on the Financing has a claim against such properties under state law if the Partnership defaults on the Financing.

2. Allocation of the Financing among the Partnership's

properties under § 752

The property contributed to the Partnership included property whose adjusted tax basis differed from its fair market value at the time of contribution. Section 704(c)(1)(A) provides that income, gain, loss, and deduction for property contributed to the partnership by a partner must be shared among the partners to take account of the variation between the adjusted tax basis of the property to the partnership and its fair market value at the time of contribution.

Section 1.704-3(a)(2) provides that except as otherwise provided in the regulations, § 704(c) 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 losses on items of contributed property cannot be aggregated.

Section 752(a) provides that any increase in a partner's share of partnership liabilities, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, will be considered as a contribution of money by such partner to the partnership.

Section 752(b) provides that any decrease in a partner's share of partnership liabilities, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, will be considered as a distribution of money to the partner by the partnership.

Section 752(c) provides that, for § 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 1.752-3(a) provides that a partner's share of the nonrecourse liabilities of a partnership equals the sum of the amounts specified in § 1.752-3(a)(1)-(3).

Section 1.752-3(a)(2) provides that the partner's share of the nonrecourse liabilities of the partnership includes 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. The gain a partner would be allocated under the hypothetical sale in § 1.752-3(a)(2) 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) 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. 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 this case, more than one item of Partnership property is subject to the Financing. We conclude, based solely on the facts submitted and the representations made, that, when determining the § 704(c) minimum gain under § 1.752-3(a)(2), the Partnership may allocate the Financing among its properties that are subject to the Financing in any amount that does not exceed the lesser of (i) the fair market value of the property or (ii) the amount of debt previously allocated to the property and repaid with proceeds of the Financing.

Section 465 Issue and Ruling

For an individual or a C corporation that satisfies the stock ownership requirement of § 542(a)(2), § 465(a) limits the loss deductions for any taxable year for an activity to the extent of the taxpayer's at-risk amount 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 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), for 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.

Section 465(b)(6)(B) defines qualified nonrecourse financing as 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.

For entities classified as partnerships under the Code, the legislative history to § 465(b)(6) indicates that financing must satisfy the requirements of § 465(b)(6) at both the partnership level and the partner level to be treated as qualified nonrecourse financing. H.R. Rep. No. 426, 99th Cong., 1st Sess. 294 (1985), 1986-3 (Vol. 2) C.B. 294; S. Rep. No. 313, 99th Cong., 2d Sess. 750 (1986), 1986-3 (Vol. 3) C.B. 750.

We conclude, based solely on the facts submitted and representations made, that the Financing is qualified nonrecourse financing under § 465(b)(6). Therefore, the partners of the Partnership will be considered at risk for their share of the Financing to the extent a creditor on the Financing has a claim against the Partnership's properties under state law if the Partnership defaults on the Financing.

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

Sincerely yours,

DANIEL J. COBURN
Assistant to the Branch Chief, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure: 6110 copy