Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

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March 22, 1999

Legend

X =

Fund =

Transferors =

Dear

This letter responds to a letter, dated March 20, 1998, as amended by a letter dated November 24, 1998, and other supplemental correspondence, submitted by your authorized representative requesting rulings concerning the federal income tax consequences of proposed contributions of property to a partnership.

The information submitted indicates that X is an investment adviser registered with the Securities and Exchange Commission under § 203 of the Investment Advisers Act of 1940. X currently manages the investment accounts of certain individuals, trusts, partnerships, corporations, and foundations under an Investment Advisory Agreement (the "Agreement"). Under the Agreement, X acts with discretionary investment authority over the assets held in an investment account.

X proposes to arrange for the Transferors to transfer the assets of their investment accounts to Fund, a securities investment trust managed by X, in exchange for units of Fund and Fund's assumption of the Transferors' liabilities, if any.

The following representations have been made regarding this transaction:

A. Fund is classified as a partnership for federal income tax purposes and Fund is not a publicly traded partnership under § 7704 of the Internal Revenue Code;

B. The adjusted basis and the fair market value of the assets of each Transferor to be exchanged for units of Fund will, in each instance, equal or exceed the sum of the liabilities to be assumed by Fund plus any liabilities to which the transferred assets are subject;

C. Each Transferor will receive units approximately equal to the fair market value of the assets transferred by the Transferor to Fund;

D. Each Transferor will contribute solely cash and/or a diversified portfolio of stocks and securities to Fund;

E. There is no plan or intention for any Transferor to transfer assets other than cash and/or a diversified portfolio of stocks and securities to Fund; and

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

For 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), 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 governments securities are acquired to meet the requirements of § 368(a)(2)(F)(ii).

The Service has been requested to rule that:

1. Each Transferor and Fund will recognize no gain or loss on the transfer of the assets in the Transferor's investment account to Fund solely in exchange for units in Fund and Fund's assumption of the Transferor's liabilities, if any;

2. Each Transferor's basis in the units received in the transaction will equal the basis of the assets transferred in exchange therefor, reduced by the sum of the Transferor's liabilities assumed by Fund or to which assets transferred are taken subject;

3. Each Transferor's holding period in units received in the transaction will include the period during which the property exchanged were held by the Transferor, provided that such property were capital assets or property described in §§ 1221 or 1231 on the date of the exchange;

4. Fund's basis in the assets received from the Transferor will equal the basis of such property in the hands of the Transferor before the exchange; and

5. Fund's holding period in the assets received from a Transferor will, in each instance, include the period during which the Transferor held such assets.

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 to the partnership 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 that would be treated as an investment company (within the meaning of § 351) if the partnership were incorporated.

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 contribution increased by the amount, if any, of gain recognized under § 721(b) to the contributing partner.

Section 1223(1) provides that where property received in an exchange acquires the same basis, in whole or in part, as the property surrendered in the exchange, the holding period of the property received includes the holding period of the property surrendered to the extent such surrendered property was a capital asset as defined in § 1221 or property described in § 1231.

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 1.723-1 of the Income Tax Regulations provides that because property contributed to a partner has the same basis in the hands of the partnership as it had in the hands of the contributing partner, the holding period of such property for the partnership includes the period during which it was held by the partner. See § 1223(2).

Section 1.351-1(c)(1) 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 in 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.

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

After applying the law to the facts submitted and representations made, we conclude that the transfers of property to Fund by the Transferors would not be transfers to an investment company (within the meaning of § 351) if Fund were incorporated, provided that these are the only transfers to Fund (except for transfers solely of cash and/or a diversified portfolio of stocks and securities). Therefore, we conclude that:

1. Fund and each Transferor will recognize no gain or loss under § 721 on the transfer of the assets in the Transferor's investment account currently managed by X to Fund in exchange for units of Fund and Fund's assumption of the Transferor's liabilities, if any;

2. Each Transferor's basis in the units of Fund received in the transaction will equal the basis of the assets exchanged by the Transferor for those units, reduced by the sum of the Transferor's liabilities assumed by Fund or to which the assets transferred were taken subject;

3. Each Transferor's holding period in the units of Fund received in the transaction will include the period during which the property exchanged was held by the Transferor, provided that such property was a capital asset or property described in §§ 1221 or 1231 on the date of the exchange;

4. Fund's basis in the assets received from a Transferor will equal the basis of such property in the hands of the Transferor before the exchange; and

5. Fund's holding period in assets received from a Transferor will, in each instance, include the period during which the Transferor held such property.

Except as otherwise provided, we express no opinion regarding the federal income tax treatment of the proposed transaction under any other provision of the Code or regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction. In particular, we express no opinion as to (i) the consequences of other transfers to Fund, 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 the Transferors, cause those transfers to be considered "transfers to an investment company," or (ii) whether the transfers are part of a plan to achieve diversification without recognition of gain under § 1.351-1(c)(5).

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling 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 the 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.

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

Under the power of attorney on file in this office, a copy of this letter is being sent to X's authorized representative.

Sincerely yours,

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

Enclosure
Copy for section 6110 purposes