

**Internal Revenue Service**

Department of the Treasury

Index Number: 721.00-00

Washington, DC 20224

Number: **199917049**  
Release Date: 4/30/1999

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:P&SI:3 / PLR-113612-98

Date:

February 1, 1999

Legend

Taxpayer =

Domestic Fund =

International Fund =

State =

Date =

a =

b =

c =

d =

e =

f =

Dear:

This letter responds to a letter, dated June 23, 1998, that was submitted by your authorized representative requesting a private letter ruling concerning the federal income tax consequences of property contributions to and distributions from a partnership.

The information submitted indicates that Taxpayer, Domestic Fund, and

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International Fund are State limited liability companies that are treated as partnerships for federal income tax purposes. On Date, Taxpayer contributed \$a of cash and an interest in a partnership with a fair market value of \$b to Domestic Fund in exchange for an interest in Domestic Fund. On Date, Taxpayer also contributed \$c of cash, a partnership interest with a fair market value of \$d, and its interest in e regulated investment companies with a total fair market value of \$f to International Fund in exchange for an interest in International Fund. Immediately after these contributions, Taxpayer distributed pro rata to its members the Domestic Fund and International Fund interests.

Taxpayer has represented that it transferred a diversified portfolio of assets to Domestic Fund and International Fund. For purposes of this representation, a portfolio of assets is diversified if it satisfies § 368(a)(2)(F)(ii) of the Internal Revenue Code, 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).

Taxpayer has also represented that:

1. Substantially all the assets of the partnerships whose interests Taxpayer contributed to Domestic Fund and International Fund are stock and securities within the meaning of §§ 351(e)(1) and 731(c)(3)(C)(i);
2. Taxpayer has never engaged in a trade or business other than holding stock and securities;
3. None of the partnerships in which Taxpayer held a 20 percent or greater interest or in which Taxpayer actively and substantially participated in management has ever engaged in a trade or business other than holding stock or securities;
4. Taxpayer is not a regulated investment company (RIC) or a real estate investment trust (REIT); and
5. Neither Domestic Fund nor International Fund was a RIC or a REIT before or after Taxpayer's contribution.

The Service has been requested to rule that 1) Taxpayer's contribution of partnership interests to Domestic Fund and International Fund (the "Funds") did not result in a recognition of gain by Taxpayer or its members; and 2) Taxpayer's distribution of interests in the Funds to its members who are eligible partners within the meaning of § 731(c)(3)(C)(iii) did not result in a recognition of gain.

Ruling #1:

Section 721(a) provides that no gain or loss is recognized to a partnership or to

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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 351(a) provides that no gain or loss is recognized if one or more persons transfer property to a corporation solely in exchange for stock 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 states that a transfer to an investment company will occur when (i) the transfer results in diversification of the transferors' interests, and (ii) the transferee is a regulated investment company (RIC), a regulated investment trust (REIT), or a corporation more than 80 percent of the value of whose assets (excluding cash and nonconvertible debt obligations) are held for investment and are readily marketable stocks or securities or interests in RICs or REITs.

Section 1.351-1(c)(6)(i) provides that a transfer of stocks and securities will not be treated as resulting in diversification if each transferor transfers a diversified portfolio of stocks and securities. A portfolio of stock 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). For this purpose, government securities are included in determining total assets, unless the government securities are acquired to meet § 368(a)(2)(F)(ii).

Section 368(a)(2)(F)(i) provides that a transaction between two “investment companies” otherwise qualifying as a reorganization will not qualify as a reorganization for any corporation in the transaction that is not a RIC, REIT, or corporation described in § 368(a)(2)(F)(ii). Section 368(a)(2)(F)(iii) defines an “investment company” as a RIC, REIT, or corporation with at least 50 percent of its assets comprised of stock or securities and 80 percent of its assets held for investment. A corporation satisfies § 368(a)(2)(F)(ii) if not more than 25 percent of the value of its “total assets” is invested in the stock and securities of 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. For purposes of this clause, all members of a controlled group of corporations (within the meaning of § 1563(a)) are treated as one issuer. Also, a person holding stock in an investment company (as defined by § 368(a)(2)(F)(iii)) is treated as holding its proportionate share of the assets held by the investment company. Section 368(a)(2)(F)(iv) provides that, in determining “total assets,” certain assets are excluded, including cash and cash items (including

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receivables) and government securities. Section 368(a)(2)(F)(vii) defines “securities” for purposes of clauses (ii) and (iii) of § 368(a)(2)(F).

After applying the law to the facts submitted and representations made, we conclude that Taxpayer’s transfer of partnership interests to Domestic Fund and International Fund did not result in a diversification of the portfolios transferred. Accordingly, no gain was recognized by Taxpayer or any of its members under § 721 on the contribution of partnership interests to Domestic Fund and International Fund in exchange for interests in the Funds.

Ruling #2:

Section 731(a)(1) provides that in the case of a distribution by a partnership to a partner gain is not recognized by the partner, except to the extent that any money distributed exceeds the adjusted basis of the partner’s interest in the partnership immediately before the distribution.

Section 731(c)(1)(A) provides that for purposes of § 731(a)(1) the term “money” includes marketable securities.

Section 731(c)(2)(B)(v) provides that, except as otherwise provided in regulations, the term “marketable securities” includes interests in any entity if substantially all the assets of the entity consist (directly or indirectly) of marketable securities, money, or both.

Section 731(c)(3)(A)(iii) provides that § 731(c)(1) does not apply to the distribution from a partnership of a marketable security to a partner if the partnership is an investment partnership and the partner is an eligible partner.

Section 731(c)(3)(C)(i) provides that the term “investment partnership” means any partnership which has never engaged in a trade or business and substantially all the assets (by value) of which have always consisted of certain specified investment-type assets.

Section 731(c)(3)(C)(iii) provides that the term “eligible partner” means any partner who, before the date of the distribution, did not contribute to the partnership any property other than certain specified investment-type assets.

Section 731(c)(3)(C)(iv)(I) provides that, except as otherwise provided in regulations, a partnership is treated as engaged in any trade or business engaged in by, and as holding (instead of a partnership interest) a proportionate share of the assets of, any other partnership in which the partnership holds a partnership interest.

Section 1.731-2(e)(4) provides that a partnership (upper-tier partnership) is not treated as engaged in a trade or business engaged in by, or as holding (instead of a

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partnership interest) a proportionate share of the assets of, a partnership (lower-tier partnership) in which the upper-tier partnership holds an interest if (i) the upper-tier partnership does not actively and substantially participate in the management of the lower-tier partnership; and (ii) the interest held by the upper-tier partnership is less than 20 percent of the total profits and capital interests in the lower-tier partnership.

After applying the law to the facts submitted and representations made, we conclude that Taxpayer is an investment partnership within the meaning of § 731(c)(3)(C). Thus, Taxpayer's distribution of interests in Domestic Fund and International Fund to those members who are eligible partners of Taxpayer within the meaning of § 731(c)(3)(C)(iii) did not result in the recognition of gain.

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.

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.

Under the power of attorney on file in this office, a copy of this letter is being sent to Taxpayer'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