Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200224014**
Release Date: 6/14/2002
Index Number: 514.07-00

Person to Contact:

Telephone Number:

Refer Reply To:
CC:FIP:3-PLR-160982-01
Date:
March 8, 2002

Legend:

A	=
B	=
C	=
D	=
E	=
a	=
b	=
c	=
d	=
e	=
f	=
g	=
h	=
Series 1	=
Series 2	=

Series 3	=
State 1	=
State 2	=
State 3	=
State 4	=
Partnership Agreement	=
Date 1	=
Date 2	=

Dear

This responds to your letter dated August 20, 2001, submitted on behalf of A, B, and C, requesting rulings under § 1.514(c)-2 of the Income Tax Regulations.

Facts

According to the information submitted and representations therein, A is a corporation that operates in a manner intended to qualify it as a real estate investment trust (REIT) within the meaning of § 856(a) of the Internal Revenue Code. D, a qualified trust within the meaning of § 401(a), holds by value more than a percent of A's common stock and preferred stock. Shares of A also are held by an unrelated financial institution and unrelated individual investors. A owns B, a qualified REIT subsidiary within the meaning of § 856(i). On Date 1, E merged into B. As a result of the merger, B acquired all of E's interest in C and became the sole general partner of C. The interest in C is held in common units, Series 1 preferred units, Series 2 preferred units, and Series 3 preferred units. B holds b percent of Series 1 preferred units and approximately c percent of common units. The rest is held by unrelated individual and institutional investors, none of which is a qualified organization within the meaning of § 514(c)(9)(C) or a partnership that has directly, or indirectly through upper-tier partnership, a qualified organization as a partner. B has approximately d percent of the capital and profits interests in C.

Section 7.1 of Partnership Agreement of C provides that

> A. Except as provided in Sections 7.2, 7.3, 7.4 and 7.5 hereof (which shall be applied first), the Profits of the Partnership for each taxable year (or other fiscal period) shall be allocated as follows:

(i) first, to the General Partner to the extent that the cumulative Losses allocated to the General Partner pursuant to Section 7.1.B(ii) exceed the cumulative Profits allocated to the General Partner pursuant to this Section 7.1.A(i);

(ii) second, pro rata (based on the respective number of Preferred Units held by them) to the holders of the Preferred Units until the cumulative amount of Profits allocated pursuant to this clause (ii) equals their cumulative Priority Return through the end of the applicable year (whether or not distributed);

(iii) third, to the holders of Common Units to the extent that the cumulative Losses allocated to the holders of Common Units pursuant to Section 7.1.B(i) exceeds the cumulative Profits allocated to the holders of Common Units pursuant to this Section 7.1.A(iii); and

(iv) thereafter, pro rata (based on the respective number of Common Units held by them) to the holders of Common Units.

B. Except as provided in Sections 7.2, 7.3, 7.4 and 7.5 hereof (which shall be applied first), the Losses of the Partnership for each taxable year (or other fiscal period) shall be allocated as follows:

(i) first, pro rata (based on the respective number of Common Units held by them) to the holders of Common Units; provided, that Losses allocated to a holder of Common Units pursuant to this Section 7.1.B(i) shall not exceed the maximum amount of Losses that can be allocated without causing that holder of Common Units to have a negative Adjusted Capital Account balance; and

(ii) thereafter, one hundred percent (100%) to the General Partner.

Section 7.2 of Partnership Agreement provides for allocation rules involving minimum gain chargeback, nonrecourse deductions, and qualified income offset.

Section 7.3 of Partnership Agreement provides for other allocation rules involving §§ 706 and 514(c)(9)(E).

Section 7.4 of Partnership Agreement provides for tax allocation rules involving §§ 704(c), 1245, and 1250.

Section 7.5 of Partnership Agreement provides for allocation rules involving nonrecourse liabilities.

In furtherance of A's objective to expand and geographically diversify its holdings, C proposes to acquire e real estate assets located in State 1, State 2, State 3,

and State 4. An unrelated contributor will contribute the assets, which are subject to approximately $f of existing mortgage indebtedness. In return, the contributor will receive approximately $g in cash and a newly-issued partnership interest in C, worth approximately $h.

You represent specifically as follows. Although the proposed transaction is being undertaken in furtherance of A's business objective to expand and diversify its real estate portfolio and A has generally contemplated, as part of its initial business plan, that a partnership controlled by it may consummate transactions such as the proposed transaction, neither A, B, C, nor any of their respective affiliates had contractual agreements or other arrangements, negotiations, or understandings (whether formal or informal) that anticipated the proposed transaction or that would have required A, B, C, or any of their respective affiliates to consummate the proposed transaction at the time of A's formation or A's acquisition of interest in C through B.

You have requested the following rulings.

1. The reduction in A's percentage share of C's overall partnership loss that will result from the proposed transaction will not cause C's tax allocations to fail to comply with the requirements of § 1.514(c)-2(b)(1)(i) in any taxable year.

2. With respect to the portion of C's taxable year that precedes the consummation of the proposed transaction and with respect to C's prior taxable years commencing with its first taxable year beginning on Date 2, § 1.514(c)-2(b)(1)(i) will be applied by taking into account only A's percentage share of C's overall partnership income and overall partnership loss prior to the proposed transaction.

3. With respect to the portion of C's taxable year following consummation of the proposed transaction and with respect to C's subsequent taxable years, § 1.514(c)-2(b)(1)(i) will be applied by taking into account only A's percentage share of C's overall partnership income and overall partnership loss as in effect following the proposed transaction.

Law and Analysis

Section 514(c)(9)(A) provides that except as provided in § 514(c)(9)(B), the term "acquisition indebtedness" does not, for purposes of this section, include indebtedness incurred by a qualified organization in acquiring or improving any real property. For purposes of this paragraph, an interest in a mortgage shall in no event be treated as real property.

Section 514(c)(9)(B)(vi) provides in part that the provisions of § 514(c)(9)(A) shall not apply in any case in which the real property is held by a partnership unless the partnership meets the requirements of §§ 514(c)(9)(B)(i) through (v) and unless (I) all of the partners of the partnership are qualified organizations, (II) each allocation to a partner of the partnership which is a qualified organization is a qualified allocation (within the meaning of § 168(h)(6)), or (III) such partnership meets the requirements of § 514(c)(9)(E).

Section 514(c)(9)(E)(i) provides that a partnership meets the requirement of § 514(c)(9)(E) if (I) the allocation of items to any partner which is a qualified organization cannot result in such partner having a share of the overall partnership income for any taxable year greater than such partner's share of the overall partnership loss for the taxable year for which such partner's loss share will be the smallest, and (II) each allocation which respect to the partnership has substantial economic effect within the meaning of § 704(b)(2). For purposes of this clause, items allocated under § 704(c) shall not be taken into account.

The fractions rule, defined in § 1.514(c)-2(b)(1)(i), is that the allocation of items to a partner that is a qualified organization cannot result in that partner having a percentage share of overall partnership income for any partnership taxable year greater than that partner's fractions rule percentage (as defined in § 1.514(c)-2(c)(2)).

Section 1.514(c)-2(b)(2)(i) provides in part that a partnership must satisfy the fractions rule both on a prospective basis and on an actual basis for each taxable year of the partnership, commencing with the first taxable year of the partnership in which the partnership holds debt-financed real property and has a qualified organization as a partner. Generally, a partnership does not qualify for the unrelated business income tax exception provided by § 514(c)(9)(A) for any taxable year of its existence unless it satisfies the fractions rule for every year the fractions rule applies.

Section 1.514(c)-2(c)(2) provides that a qualified organization's fractions rule percentage is that partner's percentage share of overall partnership loss for the partnership taxable year for which that partner's percentage share of overall partnership loss will be the smallest.

Section 1.514(c)-2(k)(1) provides that a qualified organization that acquires a partnership interest from another qualified organization is treated as a continuation of the prior qualified organization partner (to the extent of that acquired interest) for purposes of applying the fractions rule. Changes in partnership allocations that result from other transfers or shifts of partnership interests will be closely scrutinized (to determine whether the transfer or shift stems from a prior agreement, understanding, or plan or could otherwise be expected given the structure of the transaction), but generally will be taken into account only in determining whether the partnership satisfies the fractions rule in the taxable year of the change and subsequent taxable years.

Under § 1.514(c)-2(k)(1), changes in partnership allocations that result from the proposed transaction will be taken into account only in determining whether the partnership satisfies the fractions rule in the taxable year of the change and subsequent taxable years if the proposed transaction does not stem from a prior agreement, understanding, or plan or could otherwise be expected given the structure of the transaction. Therefore, after the completion of the proposed transaction, A's fractions rule percentage will be the smallest among the A's percentage shares of overall partnership loss for the taxable year of the change and subsequent taxable years.

Conclusion

Based solely on the facts submitted and representations made, we conclude as follows.

1. Assuming A otherwise satisfies § 1.514(c)-(2)(b)(1)(i), the reduction in A's percentage share of C's overall partnership loss that will result from the proposed transaction will not in and of itself cause C's tax allocations to fail to comply with the requirements of § 1.514(c)-2(b)(1)(i) in any taxable year.

2. With respect to the portion of C's taxable year that precedes the consummation of the proposed transaction and with respect to C's prior taxable years commencing with its first taxable year beginning on Date 2, § 1.514(c)-2(b)(1)(i) will be applied by taking into account only A's percentage share of C's overall partnership income and overall partnership loss prior to the proposed transaction.

3. With respect to the portion of C's taxable year following consummation of the proposed transaction and with respect to C's subsequent taxable years, § 1.514(c)-2(b)(1)(i) will be applied by taking into account only A's percentage share of C's overall partnership income and overall partnership loss as in effect following the proposed transaction.

Except as specifically provided herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether the proposed transaction stems from a prior agreement, understanding, or plan or could otherwise be expected given the structure of the proposed transaction.

In addition, no opinion is expressed as to whether the taxpayers or any other entities discussed in this ruling comply with the allocation requirements described in subchapter M, part II, of the Code. Moreover, no opinion is expressed as to whether the taxpayers or any other entities discussed in this ruling qualify as a "real estate investment trust," within the meaning of § 856(a), a "qualified REIT subsidiary," within the meaning of § 856(i)(2), a "pension held REIT," as described in § 856(h)(3)(D)(i), or any other entity taxable under subchapter M, part II, of the Code.

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

Sincerely,
Alice M. Bennett
Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions and Products)

Enclosures (2):
Copy of this letter
Copy for § 6110 purposes