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Refer Reply To:
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Date:
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LEGEND:

Master Trusts =

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Initial Feeder Funds =

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Advisor =

State A =

State B =

State C =

State D =

Dear :

This responds to your request for rulings dated August 14, 2000, and subsequent correspondence, submitted by your authorized representatives on behalf of the Initial Feeder Funds (existing and to be organized) and the Master Trusts (to be created). The rulings requested are as follows:

1. Each Initial Feeder Fund will be deemed to own a proportionate share of each asset of its corresponding Master Trust and will be deemed to be entitled to the income of the Master Trust attributable to such share for purposes of determining whether the Initial Feeder Fund satisfies the requirements of §§ 851(b)(2), 851(b)(3), 852(b)(5), 853, and 854 of the Internal Revenue Code (the "Code").

2. No Master Trust will be a publicly traded partnership taxed as a corporation under § 7704 of the Code.

3. No gain or loss will be recognized by any Master Trust or the Initial Feeder Funds upon a contribution of property by an Initial Feeder Fund solely in exchange for shares of beneficial interest in the Master Trust and the Master Trust's assumption of liabilities, if any.

4. Each Initial Feeder Fund's basis in the shares of beneficial interest received in a Master Trust will equal the basis of the assets transferred in exchange therefor, reduced by the sum of such Initial Feeder Fund's liabilities assumed by the Master Trust or liabilities to which the assets transferred were subject.

5. Each Initial Feeder Fund's holding period in shares of beneficial interest received in a Master Trust will include the period during which the property exchanged was held by the Initial Feeder Fund, provided that such property constitutes a capital asset as defined in § 1221 of the Code or property described in §1231 of the Code on the date of the exchange.

6. Each Master Trust's basis in the assets received from an Initial Feeder Fund will equal the basis of such property in the hands of the Initial Feeder Fund before the exchange.

7. Each Master Trust's holding period in the assets received from an Initial Feeder Fund will include the period during which the Initial Feeder Fund held such assets.

8. The method to be employed by each Master Trust for making forward and reverse § 704(c) allocations among its Holders, including aggregating qualified financial assets, is a reasonable method within the meaning of § 1.704-3(a)(1) and § 1.704-3(e)(3) of the Income Tax Regulations and is permitted by the Commissioner under § 1.704-3(e)(4)(iii) of the Income Tax Regulations.

FACTS

Advisor will cause each Master Trust to become business trusts established in accordance with the laws of State A. The Master Trusts will be registered with the Securities and Exchange Commission (SEC) as open-end management companies under the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq. (the "1940 Act").

The Initial Feeder Funds are, or will be, organized as corporations under the laws of State B. They have qualified for, or will qualify for, and have elected status as, or will elect status as, regulated investment companies (RICs) under Part I of subchapter M of the Code and intend to continue to so qualify. Advisor currently is the principal investment advisor of each existing Initial Feeder Fund.

Pursuant to a written plan effective on the date of contribution (the "Plan"), each Initial Feeder Fund will contribute 100 percent of its assets to the corresponding Master Trust. For the existing Initial Feeder Funds, these assets will consist of a diversified portfolio of stocks, securities, and cash. Pursuant to the Plan, it is anticipated that each newly created Initial Feeder Fund will contribute solely cash to the corresponding Master Trust in exchange for an interest in such Trust. An affiliate of Advisor may also make a contribution of cash to the Master Trust in exchange for an interest therein.

The Master Trust's investment objective will be identical to that of its corresponding Initial Feeder Fund. The assets that each existing Initial Feeder Fund contributes to a Master Trust will be managed at the Trust level, and Advisor will be the principal investment advisor of each Master Trust. The cash contributed by the newly created Initial Feeder Fund will be used to purchase investments that meet the corresponding Master Trust's investment objective, which investments will, likewise, be managed at the Master Trust level.

In connection with the above described asset transfers, the taxpayers made the following representations:

1. Pursuant to the Plan, each Initial Feeder Fund will contribute a portfolio of assets that meets the diversification requirements of § 368(a)(2)(F)(ii) of the Code to a Master Trust in exchange for an interest therein.

2. The Master Trust will require that any new fund or other transferor contributes solely cash and/or a diversified portfolio of stocks and securities that meets the diversification requirements of § 368(a)(2)(F)(ii) of the Code and § 1.351-1(c)(6) of the Income Tax Regulations.

3. There is no plan or intention for any Initial Feeder Fund or any future feeder fund to transfer assets other than cash and/or a diversified portfolio of stocks and securities to a Master Trust.

4. The adjusted basis and the fair market value of the assets of the Initial Feeder Funds to be exchanged for interests in a Master Trust will, in each instance, equal or exceed the sum of the liabilities to be assumed by the Master Trust (if any) plus any liabilities to which the transferred assets are subject.

5. Pursuant to the Plan, the Initial Feeder Funds will receive shares of beneficial interest in their corresponding Master Trusts approximately equal to the fair market value of the assets transferred to the Master Trust.

6. Each Master Trust is being organized in a manner so as to enable its classification as a partnership and not to enable investors that are RICs to make distributions that would be prohibited by Rev. Rul. 89-81, 1989-1 C.B. 266, had they invested directly in the securities held by the Master Trust.

7. Other than certain enumerated holdings disclosed to the Internal Revenue Service, the Initial Feeder Funds are not aware of any holdings by the Initial Feeder Funds that are members of a controlled group of corporations within the meaning of § 368(a)(2)(F)(ii) of the Code.

8. The existing Feeder Funds will elect to be treated as RICs under the Code in each of their first tax returns and will operate so as to meet the requirements for tax treatment as RICs.

9. Each Master Trust will invest its assets in a manner that will allow each fund that invests in the Master Trust to meet the requirements of § 851(b) of the Code.

10. Each Master Trust will require that any new fund which acquires an interest in the Master Trust will meet the diversification requirements of §§ 368(a)(2)(F)(iii) of the Code and 1.351-1(c)(6) of the Income Tax Regulations.

11. Except as required by § 704(c) of the Code and § 1.704(b)(4) of the Income Tax Regulations, allocations of specific items of income, gain, losses, deduction and credit will be proportionate to the interest of each Holder in a Master Trust.

12. For purposes of determining its required distribution under § 4982(a) of the Code, each Initial Feeder Fund which is a RIC will account for its share of items of income, gain, loss and deduction of the corresponding Master Trust in which it holds an interest as they are taken into account by the Master Trust.

LAW AND ANALYSIS

Ruling Request 1:

Section 851(b) provides that certain requirements must be satisfied in order for a domestic corporation to be taxed as a RIC and thereby to be exempt from the corporate level tax on most income.

Section 851(b)(2) provides that, to qualify as a RIC, at least 90 percent of a corporation's gross income must be derived from dividends, interest, payments with respect to securities loans (as defined in § 512(a)(5)), gains from the sale or other disposition of stocks, securities, foreign currencies, or other income derived with respect to its business of investing in such stocks, securities, or currencies.

Section 851(b)(3)(A) requires that, in order to qualify as a RIC, at the close of each quarter of the taxable year, at least 50 percent of the value of a corporation's total assets must be represented by cash and cash items (including receivables), Government securities, securities of other RICs, and other securities generally limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the corporation and to not more than 10 percent of the outstanding voting securities of such issuer.

Section 851(b)(3)(B) provides that, in order to qualify as a RIC, not more than 25 percent of the corporation's total assets may be invested in the securities (other than Government securities and the securities of other RICs) of any one issuer, or of two or more issuers that the corporation controls and which are determined, under regulations, to be engaged in the same or similar trades or businesses or related trades or businesses.

Section 852(b)(5) provides that a RIC at least 50% of the value (as defined in § 851(c)(4)) of whose total assets at the close of each calendar quarter consists of obligations described in § 103(a) is eligible to pay exempt-interest dividends, which are treated by the RIC's shareholders as interest excludable from gross income pursuant to § 103(a).

Section 853(a) provides that a RIC more than 50 percent of the value (as defined in § 851(c)(4)) of whose total assets at the close of the taxable year consists of stock or securities in foreign corporations and which meets the requirements of § 852(a) for the taxable year may elect to treat its shareholders as if they had paid certain foreign taxes incurred by the RIC for purposes of determining a shareholder's foreign tax credit under § 901.

Section 854(b)(1)(A) provides that a dividend, other than a capital gain dividend, received from a RIC qualifies for the dividends received deduction under § 243(a) to the extent so designated by the RIC provided that the RIC meets the requirements of § 852(a) for the taxable year during which it paid the dividend.

Section 854(b)(1)(B) provides that the aggregate amount that may be designated as dividends under § 854(b)(1)(A) shall not exceed the aggregate dividends received by the RIC for the taxable year.

Section 854(b)(3)(A) provides that the term "aggregate dividends received" includes only dividends received from domestic corporations.

Section 854(b)(4) provides, in part, that for purposes of determining an amount to be treated as a dividend eligible for the dividends received deduction under § 243 a payment to a RIC shall not be treated as a dividend unless, had it not been a RIC, it would have been allowed a dividends received deduction under § 243 with respect to the payment.

Section 702(b) provides with respect to a partnership that the character of items stated in § 702(a) that are included in a partner's distributive share shall be determined as if such items were realized directly from the source from which they were realized by the partnership, or incurred in the same manner as incurred by the partnership. § 702(c) provides that where it is necessary to determine the amount or character of the gross income of a partner, such amount shall include that partner's distributive share of the gross income of the partnership.

Section 1006(n)(l) of the Technical and Miscellaneous Revenue Act of 1988 added a sentence to the flush language of § 851(b) that states that income derived from a partnership or trust shall be treated as satisfying the 90 percent requirement of § 851(b)(2) only to the extent that such income is attributable to items of income of the partnership or trust which would be described in § 851(b)(2) if earned directly by the RIC. The legislative history of that sentence indicates that it was intended to clarify the general rule used to characterize items of income, gain, loss, deduction, or credit includable in a partner's distributive share, as applied to RICs that are partners. It therefore explains the relationship of § 702 to the 90 percent test under § 851(b)(2). See S. Rep. No. 445, 100th Cong., 2d Sess. 93 (1988).

Under subchapter K, a partnership is considered to be either an aggregate of its members or a separate entity. Under the aggregate approach, each partner is treated as an owner of an undivided interest in partnership assets and operations. Under the entity approach, the partnership is treated as a separate entity in which partners have no direct interest in partnership assets and operations. See S. Rep. No. 1622, 83d Cong., 2d Sess. 89 (1954); H.R. Rep. No. 2543, 83d Cong., 2d Sess. 59 (1954).

In order for each Initial Feeder Fund to qualify as a RIC under the diversification tests of § 851, the aggregate approach will have to be applied to each Initial Feeder Fund's partnership interest in a Master Trust. As an aggregate, each Initial Feeder Fund will be entitled to take into account its share of the individual items of income and assets of the Master Trust.

Rev. Rul. 75-62, 1975-1 C.B. 188, concerns a life insurance company that contributed cash to a partnership in exchange for a 50 percent interest in the partnership. The partnership held real estate as its principal asset. For the taxable year in question, § 805(b) required life insurance companies to value their assets each taxable year. For this purpose, § 805(b)(4) required that shares of stock and real estate be valued at their fair market values and that other assets be valued at their adjusted bases. The issue presented in the ruling is whether, for purposes of § 805(b)(4), the life insurance company's interest in the partnership is considered to be an investment in the real estate held by the partnership (an aggregate approach) or an investment in other property (an entity approach).

Rev. Rul. 75-62 holds that the partnership interest held by the life insurance company must be accounted for as other property for purposes of § 805(b)(4). The ruling cites §§ 705 and 741, both of which generally treat an interest in a partnership as an interest in an entity, as evidence of an intent in subchapter K to take the entity approach in questions concerning the nature of an interest in a partnership. The ruling states that the legislative history of § 805(b)(4) does not indicate that application of the entity approach to the facts of the ruling is inappropriate and that there is no compelling reason to take the aggregate approach.

The flush language of § 851(b) and its legislative history indicate that here, unlike the situation described in Rev. Rul. 75-62, Congress intended that an aggregate approach be taken in determining the nature of the partnership interests held by the Initial Feeder Funds. The flush language of § 851(b) mandates an aggregate approach in applying the 90 percent gross income test of § 851(b)(2) to RICs that hold partnership interests. It would be anomalous to suggest that Congress intended that a RIC's interest in a partnership be viewed as a direct investment in the partnership's assets for purposes of the § 851(b)(2) test but not be viewed as a direct investment in those assets for purposes of the test set out in § 851(b)(3).

The tax treatment accorded real estate investment trusts (REITs) lends further support to applying the aggregate approach to the present case. REITs were created to

provide an investment vehicle similar to the RIC for small investors to invest in real estate and real estate mortgages. See H.R. Rep. No. 2020, 86th Cong., 2d Sess. 3 (1960). Like RICs, REITs are subject to restrictions on the type of assets they can hold if they want to retain the benefits accorded them under subchapter M and are subject to certain gross income source tests. REITs and RICs also have similar distribution and holding period requirements.

Section 1.856-3(g) provides that:

> In the case of a real estate investment trust which is a partner in a partnership, as defined in § 7701(a)(2) and the regulations thereunder, the trust will be deemed to own its proportionate share of each of the assets of the partnership and will be deemed to be entitled to the income of the partnership attributable to such share. For purposes of § 856, the interest of a partner in the partnership's assets shall be determined in accordance with his capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership shall retain the same character in the hands of the partners for all purposes of § 856. Thus, for example, if the trust owns a 30-percent capital interest in a partnership which owns a piece of rental property the trust will be treated as owning 30 percent of such property and as being entitled to 30 percent of the rent derived from the property by the partnership. Similarly, if the partnership holds any property primarily for sale to customers in the ordinary course of its trade or business, the trust will be treated as holding its proportionate share of such property primarily for such purpose. Also, for example, where a partnership sells real property or a trust sells its interest in a partnership which owns real property, any gross income realized from such sale, to the extent that it is attributable to the real property, shall be deemed gross income from the sale or disposition of real property held for either the period that the partnership has held the real property or the period that the trust was a member of the partnership, whichever is the shorter.

Thus, the regulation adopts the aggregate "look-through" approach in determining how a REIT should account for its partnership interests for purposes of all of the income and asset qualification tests under § 856.

The legislative purpose underlying the creation of both RICs and REITs was to provide small investors a means of pooling their resources to invest in a particular type of assets without the imposition of corporate income tax. The qualification tests are similar for each. Therefore, although the RIC regulations do not specifically address the issue herein, it is appropriate to adopt an approach for RICs that parallels that set forth for REITs.

Based on the information and representations submitted, we rule that each Initial Feeder Fund, assuming it qualifies as a RIC and is a partner in a Master Trust, will be deemed to own a proportionate share of the assets of the Master Trust and will be deemed to be entitled to the income of the Master Trust attributable to that share for purposes of determining whether each Initial Feeder Fund satisfies the requirements of §§ 851(b)(2), 851(b)(3), 852(b)(5), 853(a), and 854. For purposes of these sections, the interests of each Initial Feeder Fund in a Master Trust shall be determined in accordance with the Initial Feeder Fund's capital interest in that Master Trust.

Ruling Request 2:

Although the Master Trusts are investment trusts, the Declarations of Trust provide a power to vary the investment of the holders, which classifies the trusts as business entities under § 301.7701-4(c) of the Procedure and Administration Regulations. Accordingly, each trust will be classified as a partnership for federal tax purposes under § 301.7701-3(b)(1)(i) of these regulations.

Beneficial interests in the Master Trusts are issued solely in private placement transactions that do not involve any “public offering” within the meaning of § 4(2) of the Securities Act of 1933, as amended (1933 Act). The Master Trusts will not register their shares under the 1933 Act, because their shares may be issued solely in private placement transactions that do not involve any “public offering” within the meaning of § 4(2) of the 1933 Act. Investments in the Master Trusts may only be made by an entity registered under the 1940 Act which would be considered a “publicly offered regulated investment company” as defined in § 67(c)(2)(B) and § 1.67-2T(g)(3).

Except as required by § 704(c) and § 1.704-1(b)(4), each partner will be allocated a pro rata share of partnership income, gain, loss, deduction and credit in accordance with the regulations under § 704(b). Each partner’s initial capital account balance will be the amount of money and the fair market value of the property contributed by the partner. Under § 1.704-1(b)(2)(iv)(f), each Master Trust will revalue its investments to fair market value as of the close of each day. Each Master Trust will adjust its partners’ individual capital accounts to reflect the partner’s share of the net change in the value of Master Trust assets from the close of the prior day to the close of the current day. Each Master Trust qualifies as a securities partnership under § 1.704-3(e)(3)(iii).

No contributions to a Master Trust nor revaluations and corresponding allocations of tax items by a Master Trust were made or will be made with a view to shifting the tax consequences of built-in gain or loss among its partners in a manner that substantially reduces the present value of the partners’ aggregate tax liability.

Section 7704(a) provides that a publicly traded partnership is treated as a corporation. Section 7704(b) and § 1.7704-1(a) provide that, for purposes of § 7704, the term “publicly traded partnership” means any partnership if interests in the

partnership are: (1) traded on an established securities market; or (2) readily tradable on a secondary market or the substantial equivalent thereof.

Section 1.7704-1(c)(1) provides that interests in a partnership are readily tradable on a secondary market or the substantial equivalent thereof if, taking into account all of the facts and circumstances, the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is comparable economically to trading on an established securities market.

Section 1.7704-1(h)(1) provides, in general, that interests in a partnership are not readily tradable on a secondary market or the substantial equivalent thereof for purposes of § 7704(b) if: (i) all interests in the partnership were issued in a transaction (or transactions) that was not required to be registered under the 1933 Act; and (ii) the partnership does not have more than 100 partners at any time during the taxable year.

Section 1.7704-1(h)(3) provides that, for purposes of § 1.7704-1(h)(1), a person owning an interest in a partnership, grantor trust, or S corporation (flow-through entity) that owns, directly or through other flow-through entities, an interest in the partnership, is treated as a partner in the partnership only if: (i) substantially all of the value of the beneficial owner's interest in the flow-through entity is attributable to the flow-through entity's interest (direct or indirect) in the partnership and (ii) a principal purpose of the use of the tiered arrangement is to permit the partnership to satisfy the 100-partner limitation of § 1.7704-1(h)(1)(ii).

The Master Trusts have represented that the number of partners in each Master Trust will be limited to 100 or fewer calculated pursuant to § 1.7704-1(h). No interest in a Master Trust has been or will be issued in a transaction (or transactions) required to be registered under the 1933 Act.

Accordingly, we rule that Master Trusts will not be "publicly traded partnerships" within the meaning of § 7704(b) of the Code.

Ruling Request 3:

Section 721(a) provides that no gain or loss is recognized to a partnership or 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, however, that § 721(a) does 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.

After applying the law to the facts submitted and representations made, we rule that the transfers by the Initial Feeder Funds to the Master Trusts are not transfers of property to a partnership that would be treated as an investment company (within the

meaning of § 351) if the Master Trusts were incorporated, provided that these are the only transfers to the Master Trusts (except for transfers solely of cash and/or a diversified portfolio of stocks and securities, within the meaning of § 1.351-1(c)(6)(i)).

Ruling Request 4:

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

Each Initial Feeder Fund's basis in a Master Trust received in the transaction will equal the basis of the assets exchanged by the Initial Feeder Fund for that interest, reduced by the sum of the Initial Feeder Fund's liabilities assumed by the Master Trust to which the assets transferred were taken subject.

Ruling Request 5:

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.

Each Initial Feeder Fund's holding period in its interest in Master Trust received in the transaction will include the period during which the property exchanged was held by the Initial Feeder Fund, provided that such property was a capital asset or property described in §§ 1221 or 1231 on the date of the exchange.

Ruling Request 6:

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

Each Master Trust's basis in the assets received from an Initial Feeder Fund will equal the basis of such property in the hands of the Initial Feeder Fund before the exchange.

Ruling Request 7:

Section 1.723-1 provides that because property contributed to a partnership 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).

Each Master Trust's holding period in assets received from an Initial Feeder Fund will, in each instance, include the period during which the Initial Feeder Fund held such property.

Ruling Request 8:

Section 704(c)(1)(A) provides that income, gain, loss, and deduction with respect to property contributed to the partnership by a partner is shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution.

Section 1.704-3(a)(1) states that the purpose of § 704(c) is to prevent the shifting of tax consequences among partners with respect to precontribution gain or loss. Under § 704(c), a partnership must allocate income, gain, loss, and deductions with respect to property contributed by a partner to the partnership so as to take into account any variation between the adjusted tax basis of the property and its fair market value at the time of the contribution. This allocation must be made using a reasonable method that is consistent with the purpose of § 704(c).

Section 1.704-3(a)(6) provides that the principles of § 1.704-3 apply to allocations with respect to property for which differences between book value and adjusted tax basis are created when a partnership revalues partnership property under § 1.704-1(b)(2)(iv)(f) (reverse § 704(c) allocations). A partnership that makes allocations with respect to revalued property must use a reasonable method that is consistent with the purposes of § 704(b) and (c).

Section 1.704-3(a)(2) indicates that, except as provided in §1.704(e)(2) and (e)(3), § 704(c) generally 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 built-in losses on items of contributed or revalued property generally cannot be aggregated.

Section 1.704-3(e)(3) sets forth a special rule allowing certain securities partnerships to make reverse § 704(c) allocations on an aggregate basis. Specifically, § 1.704-3(e)(3)(i) provides that, for purposes of making reverse § 704(c) allocations, a securities partnership may aggregate gains and losses from qualified financial assets using any reasonable approach that is consistent with the purposes of § 704(c). Once a partnership adopts an aggregate approach, the partnership must apply the same

aggregate approach to all of its qualified financial assets for all taxable years in which the partnership qualifies as a securities partnership.

Section 1.704-3(e)(3)(iii)(A) defines a securities partnership as a partnership that is either a management company or an investment partnership, and that makes all of its book allocations in proportion to the partners' relative book capital accounts (except for reasonable special allocations to a partner who provides management services or investment advisory services to the partnership). Under § 1.704-3(e)(3)(iii)(B)(1), a partnership is a management company if it is registered as a management company under the 1940 Act.

Section 1.704-3(e)(3)(ii) defines qualified financial assets as any personal property (including stock) that is actively traded, as defined in § 1.1092(d)-1 (defining actively traded property for purposes of the straddle rules). For a management company, qualified financial assets also include the following, even if not actively traded: shares of stock in a corporation; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidences of an interest in, or derivative financial instruments in, any security, currency, or commodity, including any option, forward or futures contract, or short position; or any similar financial instrument.

Section 1.704-3(e)(3)(iv) and (e)(3)(v) describe two approaches to making aggregate reverse § 704(c) allocations that are generally reasonable -- the partial netting approach and the full netting approach. However, § 1.704-3(e)(3)(i) provides that other approaches may be reasonable in appropriate circumstances.

Section 1.704-3(e)(3)(v) (the full netting approach) provides that to use the full netting approach, the partnership must establish appropriate accounts for each partner for the purpose of taking into account each partner's share of the tax gains and losses. Under the full netting approach, on the date of each capital account restatement, the partnership: (A) nets its book gains and book losses from qualified financial assets since the last capital account restatement and allocates the net amount to its partners; (B) nets tax gains and tax losses from qualified financial assets since the last capital account restatement; and (C) allocates the net tax gain (or net tax loss) to the partners in a manner that reduces the book-tax disparities of the individual partners.

Section 1.704-3(a)(10) provides that an allocation method (or combination of methods) is not reasonable if the contribution of property (or event that results in reverse § 704(c) allocations) and the corresponding allocation of tax items with respect to the property are made with a view to shifting the tax consequence of built-in gain or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability.

Furthermore, § 1.704-3(e)(3)(vi) provides that the character and other tax attributes of gain or loss allocated to the partners under an aggregate approach must:

(A) preserve the tax attributes of each item of gain or loss realized by the partnership; (B) be determined under an approach that is consistently applied; and (C) not be determined with a view to reducing substantially the present value of the partners' aggregate tax liability. The Master Trusts represent that their allocations have complied and will comply with § 1.704-3(e)(3)(vi).

Each Master Trust has elected to use the aggregate method for making reverse § 704(c) allocations described in § 1.704-3(e)(3)(v).

The Master Trust and Initial Feeder Funds also have requested permission to aggregate built-in gains and losses from qualified financial assets later contributed to a Master Trust by a partner with built-in gains and losses from revaluations of qualified financial assets held by that Master Trust for the purpose of making § 704(c) and reverse § 704(c) allocations.

The aggregation rule of § 1.704-3(e)(3) applies only to reverse § 704(c) allocations. Therefore, a securities partnership using an aggregate approach must generally account for any built-in gain or loss from contributed property separately. The preamble to § 1.704-3(e)(3) explains that the final regulations do not authorize aggregation of built-in gains and losses from contributed property with built-in gains and losses from revaluations because this type of aggregation can lead to substantial distortions in the character and timing of income and loss recognized by contributing partners. T.D. 8585, 1995-1 C.B. 120, 123. However, the preamble also recognizes that there may be instances in which the likelihood of character and timing distortions is minimal and the burden of making § 704(c) allocations separate from reverse § 704(c) allocations is great. Consequently, § 1.704- 3(e)(4)(iii) authorizes the Commissioner to permit, by published guidance or letter ruling, aggregation of qualified financial assets for purposes of making § 704(c) allocations in the same manner as that described in § 1.704-3(e)(3).

In this case, the burden to each Master Trust of making § 704(c) allocations separate from reverse § 704(c) allocations is represented to be substantial. In addition, the likelihood that this type of aggregation could be abused by a Master Trust and its partners is minimal. It is represented that each Initial Feeder Fund will qualify as a "publicly offered regulated investment company" as defined in § 67(c)(2)(B) and § 1.67-2T(g)(3)(ii) of the regulations (a "Qualified Contributor").

After applying the relevant law to the information and representations submitted, we rule that each Master Trust may aggregate built-in gains and loses from qualified financial assets contributed by its Initial Feeder Funds with built-in gains and losses from revaluations of qualified financial assets held by that Master Trust for purposes of making § 704(c)(1)(A) and reverse § 704(c) allocations and that each Master Fund's method of making § 704(c)(1)(A) and reverse § 704(c) allocations is reasonable, and is permitted by the Commissioner under § 1.704-3(e)(4)(iii), provided that a contribution or revaluation of the property and the corresponding allocations of tax items with respect to the property are not made with a view to shifting the tax consequences of built-in gain

or loss among the partners in a manner that substantially reduces the present value of the partners' aggregate tax liability and that each of the partners is a Qualified Contributor.

The Master Trusts and Initial Feeder Funds also have requested permission to use the Master Trust's method for making § 704(c) allocations, including reverse allocations, for Qualified Contributors that become partners in the Master Trusts.

It is anticipated that Qualified Contributors may become partners in the Master Trusts in the future. These new partners may contribute securities with built-in gain or loss to the Master Trusts, but only securities consistent with each Master Trust's investment objective.

After applying the relevant law to the information and representations submitted, we rule that each Master Trust's method of making § 704(c) allocations, including reverse allocations, for new partners who invest in that Master Trust is a reasonable method within the meaning of § 1.704-3(a)(1), and is permitted by the Commissioner under § 1.704-3(e)(4)(iii), provided that: (i) a contribution or revaluation of property and the corresponding allocation of tax items with respect to the property are not made with a view to shifting the tax consequences of built-in gain or loss among the partnership in a manner that substantially reduces the present value of the partners' aggregate tax liability; (ii) the partner is registered as an open-end management company under the 1940 Act and is a Qualified Contributor; and (iii) to the extent a Master Trust relies on this ruling with respect to the contribution, that Master Trust will document any such contribution on its tax return filed subsequent to the contribution.

This ruling is limited to the Master Trusts and the Initial Feeder Funds. Except as specifically ruled upon above, we express no opinion on the federal tax consequences of the transactions described above under any other provisions of the Code and regulations or on the tax treatment of any conditions existing at the time of, or effects resulting from, any transaction(s) that are not specifically covered by the above rulings.

No opinion is expressed concerning whether the Initial Feeder Funds qualify as RICs taxable under subchapter M, part I.

We express no opinion about whether subsequent transfers of property to the Master Trusts by any transferor would be considered to be part of the original transfers, thereby potentially affecting the tax consequences of the original transfers. Additionally, we express no opinion whether the above-referenced transfers are part of a plan to achieve diversification without recognition of gain under section 1.351-1(c)(5).

Ruling Eight is limited to allocations of gain or loss from the sale or other disposition of qualified financial assets made under § 704(b), § 704(c)(1)(A), and § 1.704-3(a)(6). Specifically, no opinion is expressed concerning allocations of items

other than items of gain or loss from the sale or other disposition of qualified financial assets, or the aggregation of built-in gains and losses from qualified financial assets contributed to a Master Trust by any partner other than the Initial Feeder Funds and future new partners that qualify as Qualified Contributors. In addition, each Master Trust must maintain sufficient records to enable it and its partners to comply with §§ 704(c)(1)(B) and 737.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter 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. 2001-1, 2001-1 I.R.B. 1, 46 (January 2, 2001). However, if the criteria in § 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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

A copy of this letter should be attached to the federal income tax return of each Master Trust and Initial Feeder Fund for every taxable year in which it participates in the master-feeder arrangement described in this letter.

Sincerely yours,
Acting Associate Chief Counsel
(Financial Institutions & Products)
By: Alice Bennett
Chief, Branch 3

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