

INTERNAL REVENUE SERVICE

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February 13, 2001

P1 =

X =

State W =

State Y =

Dear

This is in reply to your letter dated January 31, 2000, and subsequent correspondence, submitted on behalf of P1, requesting certain rulings regarding P1's proposal to issue unsecured debt to refinance certain outstanding debt obligations.

The information provided indicates that P1 is a State W limited partnership. X, a State Y real estate investment trust, is the managing general partner of P1. X owns in excess of 90% of the units (the "Units") of P1; the balance of the Units are owned by individuals subject to § 465 of the Internal Revenue Code. P1 primarily acquires, owns and operates multifamily residential properties, directly and through subsidiary partnerships (including limited liability companies). The aggregate gross fair market value of the property owned by P1 that is neither real property nor property incidental to the activity of holding real property will be less than 10 percent of the aggregate gross fair market value of all assets of P1 (including assets held through subsidiary partnerships).

P1 has acquired properties subject to secured nonrecourse debt. P1 also has available an unsecured line of credit (Line of Credit). P1 is able to draw upon the Line of Credit from time to time to obtain capital to meet its various needs subject to continued compliance with certain financial and other covenants. The Line of Credit is a general obligation of P1.

P1 anticipates drawing advances under the Line of Credit that will be applied to refinance mortgage debt assumed by P1 in connection with the acquisition of properties in exchange for Units in P1 (or mortgage debt that was later incurred to refinance mortgage debt that was assumed by P1 at the time of contribution). P1 owns these properties either directly or through subsidiary partnerships (including limited liability

companies) in which it owns substantially all of the economic interests and controls the general partner (or is, or controls, the managing member). To the extent that P1 draws advances under the Line of Credit for this purpose, the proceeds of the particular advances under the Line of Credit used for such purpose will be traced, under the principles set forth in § 1.163-8T of the Income Tax Regulations to the repayment of the specific mortgage debt that is refinanced. The Line of Credit also is used currently to fund other acquisition and development activity of P1.

Under the Line of Credit, as it is currently in effect, the lenders would have recourse against X in the event that a default under the Line of Credit were to occur. P1 and X intend to pursue an amendment of the Line of Credit so that neither X nor any of the partners of P1 have any personal liability for repayment of the Line of Credit. Therefore, the liabilities will become nonrecourse to the partners of P1.

In addition, P1 anticipates that it will issue unsecured debt (the "Unsecured Debt") that is not recourse to any partner of P1 or a subsidiary, related person, or any of the assets of any partner or related person. P1 intends that the Unsecured Debt will be a general obligation of P1, such that, in the case of a default, the holders of the Unsecured Debt will have a claim against all of the assets of P1, rather than against specific assets of P1.

It is anticipated that the Unsecured Debt will be issued to refinance the mortgage debt assumed by P1 in connection with the acquisitions of properties (or mortgage debt that was later incurred to refinance mortgage debt that was assumed by P1 at the time of contribution). It is also anticipated that the Unsecured Debt will be used to fund acquisition and development activity of P1. The proceeds of the Unsecured Debt will be traced, under the principles set forth in § 1.163-8T to the repayment of the specific mortgage debt that is refinanced.

P1 represents that the Unsecured Debt will provide that none of the partners of P1 and no related person to any partner (as defined in § 1.752-4(b)) will have any liability for the repayment of the Unsecured Debt.

P1 represents that neither the Unsecured Debt nor the Line of Credit will be convertible into an equity interest in P1.

P1 further represents that to the best of its knowledge the purchasers of the Unsecured Debt will be qualified purchasers that satisfy the requirements of § 49(a)(1)(D)(iv) until the earlier of (1) two years after the Unsecured Debt is issued, or (2) a registration statement with respect to the Unsecured Debt is declared effective under the Securities Act of 1933, and that during such time period, substantially all the benefits and burdens of ownership of the Unsecured Debt will inure to those purchasers.

P1 also represents that each of the lenders of the Line of Credit is a qualified person within the meaning of § 49(a)(1)(D)(iv).

Section 752(a) provides that any increase in a partner's share of liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by the partner of partnership liabilities is considered a contribution of money by the partner to the partnership. Similarly, under § 752(b), any decrease in a partner's share of liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of the individual liabilities is considered a distribution of money to the partner by the partnership.

Section 752(c) provides that, for purposes of § 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 1.752-1(a)(1) provides that a partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss for that liability under § 1.752-2.

Section 1.752-2(b) provides that except as otherwise provided in § 1.752-2(b), a partner bears the economic risk of loss for a partnership liability to the extent that, if the partnership constructively liquidated, the partner or related person would be obligated to make a payment to any person (or a contribution to the partnership) because that liability becomes due and payable and the partner or related person would not be entitled to reimbursement from another partner or person that is a related person to another partner.

Section 1.752-2(b)(3) provides that the determination of the extent to which a partner or related person has an obligation to make a payment under § 1.752(b)(1) is based on the facts and circumstances at the time of the determination. All statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying § 1.752-2, including contractual obligations outside the partnership agreement such as guarantees, indemnifications, reimbursement agreements, and other obligations running directly to creditors or to other partners, or to the partnership.

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 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).

Section 465 limits the deductions for losses for any taxable year for an activity to the extent of the total amount for which the taxpayer is at risk 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 engaged in by the taxpayer in carrying on a trade or business 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), in the case of 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 of holding real property.

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

Section 465(b)(6)(C) provides that in the case of a partnership, a partner's share of any qualified nonrecourse financing of such partnership shall be determined on the basis of the partner's share of liabilities of such partnership incurred

in connection with such financing (within the meaning of § 752).

Section 1.465-27(b)(4) provides that the personal liability of any partnership for repayment of a financing is disregarded and the financing is treated as qualified nonrecourse financing secured by real property if (i) the only persons personally liable to repay the financing are partnerships; (ii) each partnership with personal liability holds only property described in § 1.465-27(b)(2)(i); and (iii) in exercising its remedies to collect on the financing in a default or default-like situation, the lender may proceed only against property that is described in § 1.465-27(b)(2)(i) and that is held by the partnership or partnerships. Section 1.465-27(b)(5) provides that principles similar to those found in § 1.465-27(b)(4) apply in determining whether a financing of an entity disregarded for federal tax purposes is treated as qualified nonrecourse financing secured by real property.

Based on the information provided and the representations made we conclude as follows:

1. For purposes of § 752, P1 may allocate the Unsecured Debt and each advance under the Line of Credit among its multiple properties (including P1's proportional share of the properties owned by the P1 subsidiaries that qualify as partnerships for federal income tax purposes) in any amounts determined by it; provided, however, that the aggregate allocation of the Unsecured Debt and the outstanding advances under the Line of Credit to each property may not exceed the lesser of (a) the fair market value of the property, or (b) the amount of debt (previously allocated to the property) repaid with the proceeds of the Unsecured Debt and the outstanding advances under the Line of Credit.

2. For purposes of § 1.752-3(a)(2), the Unsecured Debt and the outstanding advances under the Line of Credit will be treated as nonrecourse liabilities secured by P1's assets (including P1's proportional share of the properties owned by P1's subsidiaries that qualify as partnerships for federal income tax purposes).

3. For purposes of § 752, P1 may allocate reductions in the amount of the Unsecured Debt among its multiple properties (including P1's proportional share of the properties owned by P1's subsidiaries that qualify as partnerships for federal income tax purposes) in the same manner and in the same proportion as the Unsecured Debt is initially allocated.

4. For purposes of § 752, P1 may designate each advance under the Line of Credit as a separate loan (with all advances on a particular date treated as a single advance for this purpose) and may designate repayments under the Line of Credit as repayments of one or more specified advances thereunder, with reductions in each advance under the Line of Credit allocated among P1's multiple properties (including P1's proportional share of the properties owned by P1's subsidiaries that qualify as partnerships for federal income tax purposes) in the same manner and in the same proportion as such advance is initially

allocated.

5. For purposes of § 465(b)(6)(A), the Unsecured Debt and the outstanding advances under the Line of Credit will be treated as qualified nonrecourse financing as to which no person has personal liability and that is considered secured by P1's assets (including P1's proportional share of the properties owned by the P1 subsidiaries that qualify as partnerships for federal income tax purposes).

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. The rulings set forth above regarding the use of the proceeds from the advances under the Line of Credit are conditioned on the amendment of the Line of Credit resulting in neither X nor any of the partners of P1 having any liability for repayment of the Line of Credit. Similarly, the rulings regarding the Unsecured Debt are conditioned on the representation that no partner of P1 will have any personal liability for the repayment of the Unsecured Debt. No opinion is expressed or intended as to whether the Line of Credit, as amended, or the Unsecured Debt will be treated as nonrecourse liabilities. Furthermore, no opinion is expressed regarding the tax consequences of the conversion of the Line of Credit from a recourse liability to a nonrecourse liability.

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

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to P1.

Sincerely yours,
J. THOMAS HINES
Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: 2
Copy of this letter
Copy for section 6110 purposes