



formed on Date 3 as a limited liability company that is classified as a partnership in an effort to ease the administrative and financial burden of administering and managing Trust 1 and Trust 2. On Date 4, both Trust 1 and Trust 2 contributed Assets to X.

According to the terms of both Trust Agreements, the income beneficiaries and the remaindermen of both Trust 1 and Trust 2 will be identical in all circumstances. Thus, no matter how the income and gains are allocated to Trust 1 and Trust 2, they will ultimately be allocated to the beneficiaries in the same proportions. Pursuant to X's governing documents, the Assets will be revalued at least quarterly and those revaluations will be reflected on the book capital accounts of the partners (Trust 1 and Trust 2). The same governing document also provides that book allocations will be made in accordance with book capital accounts.

### Law and Analysis

#### Requested Ruling #1:

X has requested a ruling that it qualifies as a securities partnership within the meaning of § 1.704-3(e)(3).

Section 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 purpose of § 704(c). Once a partnership adopts an aggregate approach, that 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)(2), a partnership is an investment partnership if (1) on the date of each capital account restatement, the partnership holds qualified financial assets that constitute at least 90 percent of the fair market value of the partnership's non-cash assets; and (2) the partnership reasonably expects, as of the end of the first taxable year in which the partnership adopts an aggregate approach under this paragraph (e)(3), to make revaluations at least annually.

Section 1.704-3(e)(3)(ii) defines qualified 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).

X represents that it should be treated as an investment partnership under § 1.704-3(e)(3)(iii)(B)(2). X is required to revalue capital accounts at least annually, as

all of the assets are actively traded. Furthermore, book allocations will be made in accordance with book capital accounts.

Requested Ruling #2:

X has requested a ruling that it is permitted to make allocations on an aggregate basis, netting the pre-contribution gain or loss with respect to contributed property, in accordance with § 1.704-3(e)(3).

Section 1.704-3(e)(3)(v) provides for the rules concerning the full netting approach of making reverse § 704(c) allocations on an aggregate basis. 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 book gains and losses and determining 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 capita 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 members.

Section 1.704-3(e)(3)(vi) states that the character and other tax attributes of gain or loss allocated to the partners under this paragraph (e)(3) 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.

X represents that the burden of making § 704(c) allocations, separately from reverse § 704(c) allocations, is substantial.

Requested Ruling #3:

X has requested a ruling that its method of making the allocations, is an reasonable method that is permissible under § 1.704-3(e)(3).

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 and 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 pre-contribution gain or loss. Under § 704(c), a partnership must allocate income, gain, loss, and deduction 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 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 § 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 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)(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)(i) provides that other approaches may be reasonable in appropriate circumstances.

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 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.

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 (1) preserve the tax attributes of each item of gain or loss realized by the partnership, (2) be determined under an approach that is consistently applied, and (3) not be determined with a view to reducing substantially the present value of the partners' aggregate tax liability. It is represented that X's allocations will comply with § 1.704-3(e)(3)(vi).

X has elected the aggregate method for making reserve § 704(c) allocations described in § 1.704-3(e)(3)(iv).

After applying the relevant law to the information and representations submitted, we rule that X's method of making reverse § 704(c) allocations is a reasonable method within the meaning of § 1.704-3(e)(3), provided that 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 partner's aggregate tax liability.

### Conclusions

Based on the representations made in the materials submitted and the law as stated above, we conclude the following. First, X qualifies as a securities partnership as defined in § 1.704-3(e)(3)(iii). Second, X is permitted to make allocations on an aggregate basis, netting the pre-contribution gain or loss with respect to the Assets, pursuant to § 1.704-3(e)(3). Finally, X's proposed method of making such allocations is a reasonable method that is permissible under § 1.704-3(e)(3).

Except as specifically ruled upon above, we express no opinion on the federal tax consequences of the transactions described above under any provisions of the Code and regulations, or about 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. This ruling 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 other items other than items of gain or loss from the sale or disposition of qualified financial assets, or the aggregation of built-in gains and losses from qualified financial assets contributed to X by any partner other than the partners described in this ruling. X must maintain sufficient records to enable it and its partners to comply with §§ 704(c)(1)(B) and 737. Additionally, this ruling applies only to the contributions to X by the partners for which X supplied the specific information concerning the contributed assets as described above, and not to any other contributions by the partners or any other future partner.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to your authorized representative.

Sincerely,

/s / David R. Haglund

David R. Haglund  
Senior Technician Reviewer, Branch 1  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy for section 6110 purposes

cc: