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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

**DEPARTMENT OF THE TREASURY**
**INTERNAL REVENUE SERVICE**
**WASHINGTON, D.C. 20224**

UIL 514.09-00

Date: SEP 26 2003

Contact Person:

Identification Number:

Telephone Number:

T:EO:BR3

Employer Identification Number:

Legend:

M =
N =
O =
P =
x =

Dear Sir or Madam:

This is in response to a letter dated May 13, 2003, submitted by M's authorized representatives requesting rulings under section 1.514(c)-2 of the Income Tax Regulations ("the regulations").

M is exempt under section 501(a) of the Code as an organization described in section 501(c)(3) and has been classified as an educational organization under sections 509(a)(1) and 170(b)(1)(A)(ii). M intends to invest in the limited partnership, N, described in the following paragraphs.

N is a limited partnership formed in the state of O. N intends to invest in real properties in various regions in the United States. P, the sole general partner of N, expects that N will raise up to $x of capital from unrelated third-party investors through a private placement of limited partnership interests in N. This capital, along with the proceeds of indebtedness incurred by N, will be used to acquire or improve real properties for investment. Once N receives enough subscriptions from prospective investors to provide sufficient capital for N to pursue its investment objectives, N will admit those prospective investors as limited partners at the initial closing. At the initial closing, P and the prospective investors will enter into a limited partnership

agreement, and limited partnership interests in N will be given to the investors in exchange for their respective commitments for capital contributions to N.

If less than $x of capital commitments are accepted at the initial closing, N will seek to obtain additional capital commitments from investors, including the then-existing limited partners, until the sooner of either a date next year, or the date on which N will have obtained capital commitments equal to $x. As N obtains such additional capital commitments, investors making such capital commitments will be admitted as limited partners in one or more subsequent closings.

If a limited partner fails to timely fund that limited partner's pro rata share of a capital call, P may make a default adjustment by (i) decreasing the shares of overall partnership income and overall partnership losses held by the defaulting limited partner and (ii) correspondingly increasing the shares of overall partnership income and losses held by the non-defaulting limited partners.

You have requested the following rulings:

1. The changes in the existing partners' respective percentage shares of N's overall partnership income and overall partnership loss that will result from either any subsequent closing or any default adjustment will not cause N's tax allocations to fail to comply with the requirements of section 1.514(c)-2(b)(1)(i) of the regulations.

2. With respect to N's taxable years, or portion thereof, following the initial closing and prior to the first subsequent closing or default adjustment, section 1.514(c)-2(b)(1)(i) of the regulations will be applied by taking into account solely the partners' respective percentage shares of N's overall partnership income and overall partnership loss following the initial closing and prior to the first subsequent closing or default adjustment.

3. With respect to N's taxable years, or portion thereof, following a subsequent closing or default adjustment and prior to the next subsequent closing or default adjustment, section 1.514(c)-2(b)(1)(i) of the regulations will be applied by taking into account solely the partners' respective percentage shares of N's overall partnership income and overall partnership loss following such subsequent closing or default adjustment and prior to the next subsequent closing or default adjustment.

Section 511 of the Code, in part, imposes a tax on the unrelated business taxable income of organizations described in section 501(c)(3).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the allowable deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in section 512(b).

Section 512(b) of the Code sets forth so-called "modifications," which are excluded from the computation of unrelated business taxable income. These modifications include dividends, interest, royalties, rent from real property, and gain from the sale of property.

Section 512(b)(4) of the Code provides that notwithstanding sections 512(b)(1), (2), (3), and (5), in the case of debt-financed property as defined in section 514, there shall be included as an item of gross income derived from an unrelated trade or business, the amount ascertained under section 514(a)(1), and there shall be allowed, as a deduction, the amount ascertained under section 514(a)(2).

Section 514(b)(1) of the Code defines the term "debt-financed property" as any property which is held to produce income and with respect to which there is acquisition indebtedness as defined in section 514(c).

Section 514(c)(1) of the Code provides that the term "acquisition indebtedness" means with respect to any debt-financed property the unpaid amount of (1) the indebtedness incurred by the organization in acquiring or improving such property; (2) the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; or (3) the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

Section 514(c)(9)(A) of the Code provides that except as provided in section 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) of the Code provides, in part, that the provisions of section 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 sections 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 section 168(h)(6)), or (III) such partnership meets the requirements of section 514(c)(9)(E).

Section 514(c)(9)(C)(i) of the Code provides that the term "qualified organization" means an organization described in section 170(b)(1)(A)(ii).

Section 514(c)(9)(E)(i) of the Code provides that a partnership meets the requirements of section 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 with respect to the partnership has substantial economic effect within the meaning of

section 704(b)(2). For purposes of this clause, items allocated under section 704(c) shall not be taken into account.

The fractions rule, defined in section 1.514(c)-2(b)(1)(i) of the regulations, 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 section 1.514(c)-2(c)(2)).

Section 1.514(c)-2(b)(2)(i) of the regulations 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 section 514(c)(9)(A) of the Code 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) of the regulations 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) of the regulations 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 section 1.514(c)-2(k)(1) of the regulations, 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, M's fractions rule percentage will be the smallest among the M's percentage shares of overall partnership loss for the taxable year of the change and subsequent taxable years.

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

1. Assuming M otherwise satisfies section 1.514(c)-2(b)(1)(i) of the regulations, the changes in the existing partners' respective percentage shares of N's overall partnership income and overall partnership loss that will result from either any subsequent closing or any

default adjustment will not cause N's tax allocations to fail to comply with the requirements of section 1.514(c)-2(b)(1)(i).

2. With respect to N's taxable years, or portion thereof, following the initial closing and prior to the first subsequent closing or default adjustment, section 1.514(c)-2(b)(1)(i) of the regulations will be applied by taking into account solely the partners' respective percentage shares of N's overall partnership income and overall partnership loss following the initial closing and prior to the first subsequent closing or default adjustment.

3. With respect to N's taxable years, or portion thereof, following a subsequent closing or default adjustment and prior to the next subsequent closing or default adjustment, section 1.514(c)-2(b)(1)(i) of the regulations will be applied by taking into account solely the partners' respective percentage shares of N's overall partnership income and overall partnership loss following such subsequent closing or default adjustment and prior to the next subsequent closing or default adjustment.

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.

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based.

Pursuant to a Power of Attorney on file in this office, a copy of this letter is being sent to M's authorized representatives. A copy of this letter should be kept in M's permanent records.

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

If there are any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3