Internal Revenue Service

Number: **200548004**
Release Date: 12/2/2005
Index Number: 985.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:INTL:B05
PLR-115468-05

Date:
September 05, 2005

In Re:

Taxpayer =
Subsidiary REIT =

Dear :

This is in response to a letter dated June 20, 2005, submitted by your authorized representative, requesting that we modify our ruling dated May 17, 2005. Our ruling dated May 17, 2005 was issued in response to a letter dated March 17, 2005, submitted by your authorized representative, in which you requested a ruling under Treas. Reg. §1.985-1(b)(1)(iii) permitting a subsidiary real estate investment trust ("Subsidiary REIT") to determine its functional currency by applying the principles used to determine the functional currency of a qualified business unit that is not required to use the dollar as set forth in Treas. Reg. §1.985-1(c). Additional information was received in your letter dated June 20, 2005.

This private letter ruling will supersede our ruling issued on May 17, 2005.

The ruling contained in this letter is predicated upon facts and representations submitted by the Taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the request for a ruling. Verification of factual information, representations and other data may be required as part of the audit process. Taxpayer has represented the facts described below.

FACTS:

Taxpayer is a U.S. corporation that will own substantially all the stock of Subsidiary REIT, a U.S. corporation. Taxpayer intends to make mortgage loans and secured

mezzanine loans in various European countries which have the euro as their currency ("euro loans"). Taxpayer plans to raise equity capital through an initial public offering of its shares to investors for U.S. dollars. Taxpayer will contribute the dollars to Subsidiary REIT in exchange for common stock of the subsidiary. Subsidiary REIT will convert the dollars it receives into euros at the spot rate on the date of contribution. Taxpayer intends to either negotiate the rights to acquire the euro loans and assign its rights to Subsidiary REIT or to have Subsidiary REIT use the net proceeds of the initial public offering to acquire the euro loans. In a letter dated June 20, 2005, Taxpayer made the additional representations that Subsidiary REIT may invest in euro-denominated mortgage-backed securities and debt obligations collateralized by mortgage-backed securities and that in the course of potential workouts involving the euro loans, Subsidiary REIT may own real estate and interests in entities owning real estate in euro-based countries.

Taxpayer and Subsidiary REIT intend to qualify as real estate investment trusts under Subchapter M of the Internal Revenue Code. They will be domestic corporations for federal income tax purposes.

Subsidiary REIT will make the euro loans in euros. The gross income of Subsidiary REIT is expected to consist of interest income from the euro loans. Taxpayer represents that Subsidiary REIT will conduct its activities in euros and will keep its books and records in euros. Subsidiary REIT will not have employees in the United States or conduct business in the United States. Subsidiary REIT will not enter into transactions in dollars with the exception of meeting administrative expenses.

Subsidiary REIT will make distributions to Taxpayer in euros. Taxpayer will immediately convert these distributions into dollars and, after setting aside a portion of the distribution to cover expenses, will distribute the remainder to its shareholders.

LAW:

In general, section 985 provides that all determinations for Federal income tax purposes shall be made in the taxpayer's functional currency. Section 985(a). Treas. Reg. § 1.985-1(b)(1)(iii) provides that except as otherwise provided by ruling or administrative pronouncement, the U.S. dollar shall be the functional currency of a QBU that has the United States as its residence as defined in section 988(a)(3)(B). Treas. Reg. § 1.989(a)-1(b)(2)(i) provides that a corporation is a QBU. Section 988(a)(3)(B)(i)(II) provides that the United States shall be the residence of a corporation which is a United States person. Section 7701(a)(30) provides, in part, that the term "United States person" means a domestic corporation. Section 7701(a)(4) provides that the term "domestic," as applied to a corporation, means created or organized in the United States or under the law of the United States or any State. See also Treas. Reg. § 1.988-4(d)(1)(ii).

Treas. Reg. § 1.985-1(c)(1) provides that if a QBU is not required to use the dollar as its functional currency, then its functional currency shall be the currency of the economic environment in which a significant part of the QBU's activities are conducted, if the QBU keeps, or is presumed to keep, its books and records in such currency. Treas. Reg. § 1.985-1(c)(2) provides that the economic environment in which a significant part of the QBU's activities are conducted shall be determined by taking into account all the facts and circumstances. Treas. Reg. § 1.985-1(c)(2)(i) sets forth some facts and circumstances which are considered when determining the economic environment in which a significant part of the QBU's activities are conducted.

The General Explanation of the Tax Reform Act of 1986 states that "[i]n appropriate circumstances, a domestic QBU (such as a regulated investment company organized to invest in securities denominated in a specific currency) may have a foreign currency as the functional currency." Staff of the Joint Committee on Taxation, 100th Cong., 1st Sess., General Explanation of the Tax Reform Act of 1986, at 1093-94 (Comm. Print 1987).

ANALYSIS:

Absent a ruling to the contrary, Subsidiary REIT's functional currency would be the U.S. dollar because it is a U.S. corporation. Consequently, it would recognize foreign currency gain or loss on every section 988 transaction because such transactions would be denominated in a nonfunctional currency to the REIT. See section 988 and Treas. Reg. § 1.988-1(a). Moreover, any QBUs of Subsidiary REIT with a currency other than the dollar as their functional currency would be subject to section 987. Since foreign currency gain or loss is not expressly listed as qualifying income in sections 856(c)(2) or 856(c)(3), and since currency fluctuations could affect the valuation of assets under section 856(c)(4), Subsidiary REIT risks losing REIT status if it is not permitted to adopt the euro as its functional currency.

If the ruling requested herein is issued, Subsidiary REIT's functional currency would be determined by applying the principles of Treas. Reg. § 1.985-1(c). Under these principles, Subsidiary REIT would be eligible to adopt the euro as its functional currency. This conclusion is consistent with the language contained in the General Explanation of the Tax Reform Act of 1986 as set forth above.

Based solely on the facts and representations submitted, Taxpayer may apply the principles of Treas. Reg. § 1.985-1(c)(2)(i) to determine the functional currency of Subsidiary REIT. Should Subsidiary REIT properly adopt the euro as its functional currency, it will compute its taxable income or loss in the euro and translate its taxable income into dollars using the average exchange rate for the taxable year.

No opinion is expressed regarding the proper functional currency of a REIT under the principles of Treas. Reg. § 1.985-1(c).

No opinion is expressed whether the REITs qualify as real estate investment trusts under section 856.

No opinion is expressed regarding the character of dividends or other REIT income distributed by the REITs to U.S. shareholders, or the character of income or loss realized on the sale by shareholders of their ownership interest in the REIT.

No opinion is expressed regarding the treatment of foreign currency received as dividends in the hands of the shareholders.

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

It is important that a copy of this letter be attached to the Federal income tax return of the taxpayers involved for the taxable year in which the determination covered by this letter is made.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the Taxpayer.

Sincerely,

_____
Jeffrey L. Dorfman
Chief, Branch 5 International

cc: