Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:

Telephone Number:

Refer Reply To:
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PLR-134974-04

Date:
September 02, 2005

In Re:

LEGEND

Company	=
Parent	=
Operating Partnership	=
Investors	=
Entity A	=
Entity B	=
Corporation A	=
Entity C	=
Entity D	=
State 1	=
Country 1	=
Country 2	=
Country 3	=
Currency 1	=
Project 1	=

A Percent =
B Percent =
X Percent =
Y Percent =

Dear :

This is in response to your letter dated June 15, 2004, in which you request a ruling under Treas. Reg. § 1.985-1(b)(1)(iii) that Company may use a currency other than the U.S. dollar as its functional currency. Specifically, you request a ruling that permits Company 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).

The ruling contained in this letter is predicated upon facts and representations submitted by Company 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. Company has represented the facts described below.

FACTS:

Parent is a U.S. Corporation that has elected to be taxed as a real estate investment trust ("REIT") under subchapter M of the Internal Revenue Code. Parent holds a majority of the interests in Operating Partnership, a U.S. partnership and the sole shareholder in Company.

Operating Partnership owns all of the interests in Corporation A, a State 1 corporation that is a taxable REIT subsidiary under section 856(l), and Company, a State 1 limited liability company that is currently treated as a disregarded entity for federal income tax purposes. However, Company intends to qualify as a real estate investment trust under subchapter M of the Internal Revenue Code.

Company owns all of the interests in Entity A, a Country 2 entity that is treated as a disregarded entity for federal income tax purposes. Entity A owns all of the interests in a newly formed Country 1 entity ("Newco"), which will be treated as a disregarded entity for federal income tax purposes.

Newco owns A Percent interest and Corporation A owns B Percent interest in Entity B, which is a Country 1 entity that is treated as a partnership for federal income tax purposes. Entity B owns X Percent interest and Company owns Y Percent interest in

Entity C, which was formed under the laws of Country 1. Entity C is treated as a partnership for federal income tax purposes.

Entity C owns all of the interests of Entity D, which is a Country 3 entity that is treated as a disregarded entity for federal income tax purposes. Entity D owns Project 1.

Company represents that the majority of the activities of Company, Entity A, Entity B, Entity C, Entity D, and Newco will be conducted in Currency 1. Company represents that the following will be conducted in Currency 1: contributions, distributions, invoice payments, borrowing and lending of funds, acquisition of assets, filing of tax returns, and other administrative acts. Additionally, Company represents that all significant revenues and expenses will be incurred in Currency 1. Company anticipates that a small amount of administrative expenses may be satisfied in the US dollar.

Company, Entity A, Entity B, Entity C, and Newco will have no employees. Entity D will have only Country 3 employees. Neither Company, Entity A, Entity B, Entity C, Entity D, nor Newco will conduct a trade or business within the United States. These entities will maintain separate books and records in Currency 1.

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) 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; a partnership is a QBU of a partner; and a trust is a QBU of a beneficiary.

An eligible entity that files an election under section 856(c)(1) to be treated as a real estate investment trust is treated as having made an election to be classified as an association as of the first day the entity is treated as a real estate investment trust. Treas. Reg. §301.7701-3(c)(1)(v)(B). An association as determined under Treas. Reg. §301.7701-3 is a corporation. Treas. Reg. §301.7701-2(b)(2).

Section 988(a)(3)(B)(i)(II) provides that the United States shall be the residence of a corporation, partnership or trust which is a United States person. Section 988(a)(3)(B)(i)(III) states that generally the residence of a corporation or partnership which is not a United States person shall be a country other than the United States. Section 988(a)(3)(B)(ii) states an exception to the above rule, that in the case of a QBU of any taxpayer, the residence of such unit shall be the country in which the principal place of business of the QBU is located.

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 a non-inclusive list of 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:

If Company is required to use the U.S. dollar as its functional currency pursuant to Treas. Reg. § 1.985-1(b)(1)(iii), it would recognize foreign currency gain or loss on every section 988 transaction because such transactions would be denominated in a currency that would be non-functional currency to Company. See section 988 and Treas. Reg. § 1.988-1(a). Moreover, any QBU of Company with a currency other than the dollar as its functional currency would generally 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), Company risks losing REIT status if it is not permitted to adopt Currency 1 as its functional currency.

If the ruling requested herein is issued, Company’s functional currency would be determined by applying the principles of Treas. Reg. § 1.985-1(c). Under these principles, Company would be eligible to adopt Currency 1 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, the principles of Treas. Reg. § 1.985-1(c)(2) may be applied to determine the functional currency of Company. Should Company properly adopt Currency 1 as its functional currency, it will compute its

taxable income or loss in that currency 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 Company under the principles of Treas. Reg. § 1.985-1(c).

No opinion is expressed whether Company or any entity referred to herein qualifies as a real estate investment trust under section 856 or as a taxable REIT subsidiary under section 856(l).

No opinion is expressed regarding the character of dividends or other income distributed by Company to U.S. investors, or the character of income or loss realized on the sale by investors of their ownership interests in Company.

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

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 representatives below.

Sincerely,

_____
Theodore David Setzer
Senior Counsel, Branch 5
(International)

CC: