

**Internal Revenue Service**

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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:BR5  
PLR-154358-04

Date:  
April 29, 2005

In Re:

LEGEND

Company

Parent  
State A  
Country 1  
Currency 1

Dear \_\_\_\_\_ :

This is in response to your letter dated October 13, 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:

Company is the direct subsidiary of Parent. Company and Parent are State A corporations and each intend to qualify as real estate investment trusts under Subchapter M of the Internal Revenue Code.

Currently, Parent is negotiating the purchase of Country 1 real estate and plans to assign its right to acquire the Country 1 real estate to Company, which will acquire that real estate using Currency 1, Parent common stock or a combination of Parent common stock and Currency 1. In addition to the property that Company will acquire through the assignment of Parent's right to acquire Country 1 real estate, Company will acquire other real estate in Country 1. Company plans to lease the Country 1 real estate to third parties. Company will hold the Country 1 real estate through wholly-owned Country 1 limited liability companies that will elect to be treated as disregarded entities for federal income tax purposes. In addition to rental income from leases, the gross income of Company will also include gain from the sale of Country 1 real estate. The amounts will be denominated in Currency 1. Company will not recognize gain from the sale of Country 1 real estate on a regular basis because Company plans to hold the Country 1 real estate for long-term appreciation.

Company will maintain separate books and records denominated 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)(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, Company's functional currency would be the U.S. dollar because Company is a U.S. corporation. Consequently, Company 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 QBUs of Company 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), Company risks losing REIT status if it is not permitted to adopt a functional currency as determined by applying the principles of Treas. Reg. § 1.985-1(c).

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 as its functional currency, the currency of the economic environment in which a significant part of Company's activities is conducted. 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)(i) may be applied to determine the functional currency of Company. Should Company properly adopt the currency of the economic environment in which a significant part of Company's activities are conducted 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 Parent qualifies as a real estate investment trust under section 856.

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

Sincerely,

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Jeffrey L. Dorfman  
Chief, Branch 5 International