Internal Revenue Service

Number: **201523018**
Release Date: 6/5/2015

Index Number: 7704.00-00, 7704.03-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:03
PLR-147157-13

Date:
January 29, 2015

Company:

State:

Dear :

This letter responds to a letter dated November 14, 2013, submitted on behalf of Company, requesting that income derived from standard interest rate swaps, forward-start interest rate swaps, interest rate caps and treasury locks is qualifying income within the meaning of § 7704(d)(1) of the Internal Revenue Code.

FACTS

The information submitted states that Company is a publicly-traded partnership within the meaning of section 7704(b) organized under the laws of State. Company has not elected to be taxed as an association for federal tax purposes. Company is not engaged in a "financial or insurance business" within the meaning of § 7704(d)(2)(A).

In order to finance asset acquisitions and conduct the operations of its business, Company periodically issues both fixed-rate and floating-rate debt securities. The interest Company pays on the debt securities is a function of two factors: (1) the market reference interest rate (for example, U.S. Treasury Bonds for fixed-rate debt or London Interbank Offer Rate ("LIBOR") for floating-rate debt), and (2) Company's credit risk. Company enters into Standard Interest Rate Swaps, Forward-Start Interest Rate Swaps, Interest Rate Caps, and Treasury Locks (each defined below and, together, the

"Financial Transactions") to manage its exposure to the first interest rate factor, the market reference rate on its fixed-rate and floating-rate debt.

In some cases, the Financial Transactions entered into by Company are integrated with the related debt instruments under § 1.1275-6 of the Income Tax Regulations. Company is requesting a ruling only on Financial Transactions that are not integrated.

The Financial Transactions

Standard Interest Rate Swaps

A Standard Interest Rate Swap allows Company to swap a fixed rate cash flow in exchange for a floating rate cash flow (a "fixed for floating swap") or a floating rate cash flow for a fixed rate cash flow (a "floating for fixed swap"). In a fixed for floating swap, Company agrees to pay a counterparty a fixed interest rate on a notional principal amount. The counterparty agrees to pay Company an amount equal to a floating index rate, such as LIBOR, multiplied by the notional principal amount. A floating for fixed swap operates in the same manner, except that Company pays a counterparty a cash flow equal to a floating rate multiplied by the notional amount, and would receive a cash flow equal to a fixed rate on the notional amount.

Forward-Start Interest Rate Swaps

A Forward-Start Interest Rate Swap is a transaction whereby Company locks in a spot interest rate for a period prior to the issuance of its fixed-rate debt securities (a "forward lock") or to convert an expected floating-rate debt securities offering into a fixed-rate instrument (a "forward floating for fixed swap"). In a forward lock, Company agrees to pay a counterparty a fixed interest rate on a notional principal amount for a fixed period that begins on the date of the anticipated debt issuance. The counterparty agrees to pay Company an amount equal to a floating-rate index, such as LIBOR, multiplied by the notional principal amount for a fixed period that begins on the date of the anticipated debt issuance. While periodic payments may be obligated once the fixed period begins, a forward lock is typically settled on the expected date of the anticipated debt issuance. The payment on the settlement date is determined by the present value of net payment obligations under the forward lock. A forward floating for fixed swap operates in the same manner as a floating for fixed swap except that its effective date is in the future because its term coincides with an expected floating-rate debt issuance and not an existing floating-rate debt issuance. As with a floating for fixed swap, if Company is owed money on a net basis by its counterparty, Company realizes income on the swap.

Interest Rate Caps

In an Interest Rate Cap, Company agrees to pay to a counterparty an upfront fixed payment. The counterparty agrees to pay to Company an amount equal to a floating index, such as LIBOR, multiplied by the notional principal amount, if, and only if, the floating index rate exceeds a specified cap rate on a specified payment date.

Treasury Locks

A Treasury Lock is an arrangement where an unrelated party agrees to purchase at a fixed price a U.S. Treasury bond with an interest rate equal to the rate in effect on the date of the agreement. The purchase is generally consummated on the date Company expects to be able to issue debt securities. While not the intended result, Company may settle a Treasury Lock prior to the issue date for its debt securities if, in its judgment, the risk of an unfavorable movement in interest rates had declined or doing so would maximize its income from the Treasury Lock and thereby effectively minimize the interest cost of the anticipated issuance of debt securities.

LAW AND ANALYSIS

Section 7704(a) provides generally that a publicly traded partnership shall be treated as a corporation.

Section 7704(b) provides that the term “publicly traded partnership” means any partnership if (1) interests in such partnership are traded on an established securities market, or (2) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Section 7704(c)(1) provides, in part, that § 7704(a) shall not apply to any publicly traded partnership for any taxable year if such partnership met the gross income requirements of § 7704(c)(2) for such taxable year and each preceding taxable year beginning after December 31, 1987, during which the partnership (or any predecessor) was in existence.

Section 7704(c)(2) provides that a partnership meets the gross income requirements of § 7704(c)(2) for any taxable year if 90% or more of the gross income of such partnership for such taxable year consists of qualifying income.

Section 7704(d)(1)(A) provides that, except as otherwise provided in § 7704(d), the term “qualifying income” includes interest.

Section 7704(d)(2) provides that interest shall not be treated as qualifying income if (A) such interest is derived in the conduct of a financial or insurance business, or (B) such interest would be excluded from the term “interest” under § 856(f).

Section 1.7704-3(a)(1) provides, in part, that for purposes of § 7704(d)(1), qualifying income includes income from notional principal contracts (as defined in § 1.446-3) and other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner. Income from a notional principal contract is included in qualifying income only if the property, income, or cash flow that measures the amounts to which the partnership is entitled under the contract would give rise to qualifying income if held or received directly by the partnership.

Section 1.7704-3(a)(2) provides, in part, that qualifying income described in § 1.7704-3(a)(1) does not include income derived in the ordinary course of a trade or business.

Section 1.446-3(c)(1) defines a notional principal contract as a financial instrument that provides for the payment of amounts by one party to another at specified intervals calculated by reference to a specified index upon a notional principal amount in exchange for specified consideration or a promise to pay similar amounts. Section 1.446-3(c)(1) further provides that this definition of a notional principal contract includes interest rate swaps and interest rate caps.

In order to qualify under section 1.7704-3(a)(1), the Financial Transactions must qualify as income from a notional principal contract as defined in § 1.446-3 or as other substantially similar income.

The Standard Interest Rate Swaps and Interest Rate Caps are specifically included in the definition of a notional principal contract in § 1.446-3 and therefore produce income from a notional principal contract. However, income from a notional principal contract is included in qualifying income only if the property, income, or cash flow that measures the amounts to which the partnership is entitled under the contract would give rise to qualifying income if held or received directly by the partnership.

Payments due under a Standard Interest Rate Swap or an Interest Rate Cap are measured by reference to an interest rate or interest rate index and would give rise to interest income if held or received directly by Company.

Although the Forward-Start Interest Rate Swaps and the Treasury Locks are not among the instruments specifically listed in the definition of a notional principal contract, they are both ordinary and routine transactions and, in this case, were entered into for the same purpose as a notional principal contract, that is to lock in an interest rate or manage the risk of interest rate movements on Company's borrowings. Section 1.7704-3(a)(1) provides that the Commissioner may determine that income and gain from ordinary and routine investments substantially similar to notional principal contracts may also constitute qualifying income for purposes of § 7704(d)(1). It is therefore unnecessary to determine whether the Forward-Start Interest Rate Swaps and the Treasury Locks meet the definition of a notional principal contract in § 1.446-3.

CONCLUSION

Based solely on the facts and representations submitted, we conclude that the income Company derives from each of the four types of Financial Transactions is qualifying income within the meaning of § 7704(d)(1) and § 1.7704-3(a)(1).

Except for the specific ruling above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion as to whether Company's Financial Transactions can be integrated with the related debt instruments under § 1.1275-6, as well as to whether Company is taxable as a partnership for federal tax purposes. We also express or imply no opinion as to whether the Forward-Start Interest Rate Swaps or the Treasury Locks meet the definition of a notional principal contract in § 1.446-3. Finally, no opinion is expressed or implied as to whether Company meets the 90 percent gross income requirement of § 7704(c) in any taxable year.

The ruling contained in this letter is based upon information and representations submitted by Company and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. However, in the event of a technical termination of Company under § 708(b)(1)(B), the resulting partnership may continue to rely on this ruling in determining its qualifying income under § 7704(d)(1)(E). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with a power of attorney on file with this office, we are sending a copy of this letter to Company's authorized representatives.

Sincerely,

Holly A. Porter
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):
Copy of this letter
Copy for § 6110 purposes