



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

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ROCKY MOUNTAIN DISTRICT COUNSEL - DENVER
CC:WR:RMD:DEN

FROM: Chief, Branch 4
OFFICE OF ASSOCIATE CHIEF COUNSEL
(INTERNATIONAL) CC:INTL

SUBJECT:

This Field Service Advice responds to your memorandum dated February 8, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

LEGEND:

US1 =

US2 =

Px =

USS =

FPshp1 =

FPshp2 =

FCorp1 =

FCorp2 =

Country X =

Date 1 =

Date 2 =

business A =

business B =

\$aa =

\$aaa =

\$bb =

\$cc =

\$dd =

\$ee =

\$ff =

\$gg =

ISSUES:

1. Are transfers of the Px partnership interests by domestic affiliates of US1 and US2 to foreign partnerships FPshp1 and FPshp2, followed by transfers of the FPshp1 and FPshp2 partnership interests by the domestic affiliates to FCorp1, a foreign corporation, treated as transfers by each partner of its pro rata share of the partnership assets under section 367(a)(4) of the Code? Do the TEFRA

partnership provisions under sections 6221 - 6234 of the Code apply to the transfer of the partnership interests?

2. Assuming section 367(a)(4) applies to treat the transfer of the partnership interests as a transfer by each partner of its pro rata share of the partnership assets, did the partners make a permissible election under Treas. Reg. 1.367(d)-1T(g)(2) to treat the transfer of the partnerships' operating intangibles as a deemed sale at the date of the transfer?

3. Is the taxpayer required to recognize gain under section 904(f)(3) on the transfer to a foreign partnership of (i) tangible business assets, (ii) stock of foreign corporations, and (iii) operating intangibles? If so, to what separate limitation category under section 904(d) should the gain be assigned?

4. Does the gain recognized on the deemed sale of the operating intangibles under Treas. Reg. 1.367(d)-1T(g)(2) reduce the amount of foreign branch losses which is potentially recaptured as income under Treas. Reg. 1.367(a)-6T?

CONCLUSIONS:

1. Because the taxpayers elected under section 1492(2)(B) to apply principles similar to those under section 367, the transfers of the partnership interests to the foreign partnerships were subject to section 367(a)(4), which treats the transfer of the partnership interests as if the partners transferred their pro rata shares of the assets of the partnership for purposes of section 367. The TEFRA provisions do not apply because any income recognized by the partners under section 367(a)(4) is recognized at the partner level and does not constitute partnership items of income.

2. Assuming the intangibles transferred satisfy the definition of operating intangibles as described in Treas. Reg. 1.367(a)-1(d)(5)(ii), the taxpayers' election to treat the transfer as a deemed sale of the intangibles is permissible under Treas. Reg. 1.367(d)-1T(g)(2), because the taxpayer notified the Service of the election pursuant to section 6038B and its regulations and reported the gain as gross income for the taxable year of the transfer.

3. (i) The taxpayer is required to recognize gain under section 904(f)(3) on the transfer of the tangible business assets because that transfer is a disposition of property subject to section 904(f)(3). The taxpayer's overall foreign loss account in the general limitation category is reduced by the amount of gain recognized.

(ii) The facts submitted do not provide the information necessary to make a determination as to whether the transfer of the stock is a disposition of property to which section 904(f)(3) applies.

(iii) The transfer of the operating intangibles is a disposition of property to which section 904(f)(3) applies. Although the taxpayer recognizes U.S. source gain on this transfer under section 367(d), the taxpayer's overall foreign loss account in the general limitation category is reduced by the amount of gain recognized.

4. Because the amount recognized under section 904(f)(3) is greater than the amount of foreign branch losses, the amount recognized under section 904(f)(3) reduces the foreign branch losses in their entirety under Treas. Reg. 1.367(a)-6T(e). Gain recognized on the deemed sale of the operating intangibles is subject concurrently to sections 367(d) and 904(f)(3) but is recognized only once and reduces the applicable OFL account under Treas. Reg. 1.904(f)-2(a).

FACTS:

US1 is a domestic corporation and one of the largest business A providers in the United States. US1 owned, through its domestic affiliates, a 50 percent interest in Px, a domestic partnership. US2 is an unrelated domestic corporation and one of the largest business B providers in the United States. US2 also owned, through its domestic affiliates, a 50 percent interest in Px. Px was formed as a joint venture between the US1 and US2 affiliates in order to establish a business A presence in Country X.

Px owned all the stock of USS, a domestic corporation, whose assets consisted entirely of the stock of Country X corporations engaged in business A. On Date 1, USS transferred all of its assets to FCorp2, a newly formed Country X corporation, in a reorganization under section 368(a)(1)(D) of the Code, in which USS received all the stock of FCorp2 and distributed that stock to Px in dissolution of USS. A gain recognition agreement was entered into with respect to the transfer of the Country X corporations to FCorp2, pursuant to Notice 87-85, 1987-2 CB 395 and Treas. Reg. 1.367(a)-3T(g).

According to the taxpayer, on Date 1, the domestic affiliates of US1 and US2 separately contributed their Px partnership interests to two newly formed Country X unlimited companies (FPshp1 and FPshp 2), which were treated as partnerships for U.S. tax purposes. The domestic affiliates of US1 and US2 reported the transfer of their Px partnership interests by filing Forms 926 and electing under section 1492(2)(B) to apply principles similar to the principles of section 367 to the transfer. Because section 367(a)(4) treats the transfer of a partnership interest as if each

partner transferred its pro rata share of the assets of the partnership, the domestic affiliates reported on their Forms 926 their pro rata share of the assets of the partnership (Px) and gain recognized on the transfer of operating intangibles under Treas. Reg. 1.367(d)-1T(g)(2).

The assets of Px (as reported on the Forms 926) consisted of trade or business property; stock in Country X corporations for which gain recognition agreements were filed pursuant to Notice 87-85 and Treas. Reg. 1.367(a)-3T(g); and operating intangibles for which an election was made under Treas. Reg. 1.367(d)-1T(g)(2) to treat the transfer as a deemed sale of the intangibles. Because Px was engaged in business A in Country X, it constituted a foreign branch for which the taxpayers reported foreign branch losses which were subject to recapture under section 367(a)(3)(C) and overall foreign losses which were subject to recapture under section 904(f)(3).

According to the taxpayer, on Date 2 (one day after Date 1), the domestic affiliates of US1 and US2 contributed their interests in FPshp1 and FPshp2 (received in the exchange above) to FCorp1, a newly formed Country X corporation in a section 351 exchange. Property other than the partnership interests may have been contributed to FCorp1. It is not clear whether the stock of FCorp2 was transferred. The assets of FPshp1 and FPshp2 consisted solely of the partnership interest in Px. Under section 367(a)(4), the domestic affiliates were treated as transferring the underlying assets of FPshp1 and FPshp2, and because their assets consisted of solely the Px partnership interest, the domestic affiliates were also treated as transferring the underlying assets of Px to FCorp1. On the Forms 926, the pro rata share of Px's assets was reported as being transferred by the partners. The domestic affiliates filed gain recognition agreements under Notice 87-85 and Treas. Reg. 1.367(a)-3(g) on the subsequent transfer of the Country X stock to FCorp1. Shortly after Date 2, an initial public offering of FCorp1 stock was made on U.S. and Country X stock markets. Advice was not requested on whether section 708 caused a termination of the Px, FPshp1 and FPshp2 partnerships on the transfer of interests in the partnerships.

For the 1994 year, the US1 consolidated group had a balance of approximately \$aa in its overall foreign loss account attributable to the general limitation category, and the US2 consolidated group had a balance of approximately \$aaa in its overall foreign loss account attributable to the general limitation category. No facts were submitted as to whether the taxpayers had overall foreign loss accounts in any other category.

On Date 1 (the date of the transfer of the Px interests to FPshp1 and FPshp2), the US1 group had \$bb of previously deducted branch losses subject to

recapture under section 367(a) and the US2 group had \$cc of previously deducted branch losses subject to recapture.

According to the taxpayer, the US1 subsidiaries' proportionate share of the built-in gain on the assets transferred is as follows: (i) tangible business assets-\$dd, (ii) stock-\$ee, and (iii) operating intangibles-\$ff. US2 also took the position that its proportionate share of the built-in gain on the intangible assets totaled \$ff. Information regarding US2's proportionate share of the built-in gain on the tangible business assets and the foreign stock was not submitted with the FSA request. On its return, US1 reported the gain on the tangible business assets and operating intangibles. The gain on the tangible assets was recognized under section 904(f)(3) and the gain on the intangibles was recognized under Treas. Reg. § 1.367(d)-1T(g)(2). US1 reduced its OFL account in the general limitation category by the amount of gain recognized.

US1 did not recognize gain on the stock under section 367 because it entered into a gain recognition agreement in accordance with the rules under section 367. US1 also did not recognize gain on the stock under section 904(f)(3) because it claimed that it held the stock with a substantial investment motive and that the disposition of the stock was therefore not subject to section 904(f)(3).

LAW AND ANALYSIS

Sections 1491 and 367 Issues

Under former section 1491 of the Code, the transfer of property by a domestic corporation to a foreign partnership is subject to a 35 percent excise tax on the excess of the fair market value of the property transferred over its adjusted basis, plus any gain recognized on the transfer. Section 1492(2)(B) provides an exception to this excise tax if the U.S. transferor elects before the transfer to apply principles similar to the principles of section 367 to the transfer. While sections 1491-1494 were repealed by the Taxpayer Relief Act of 1997 (P.L. 105-34, sec. 1131(a)), the repeal of these sections was effective for transfers occurring on or after August 5, 1997, which was after the date of the transfer.

The section 1491 transfers are reported on Form 926 which is filed on the date of the transfer (Treas. Reg. 1.1494-1(a)). On Form 926, the taxpayer may mark a box (on line 6d) indicating that the transfer is excepted from the section 1491 excise tax because the taxpayer is electing to apply the principles of section 367 to the transfer. The Form 926 also requires the taxpayer to provide an attachment to the form explaining the application of section 367 principles to the

transfer, as well as information that would have been required under section 6038B if the transfer actually had been described in section 367 (see line 6e).

If the form of the transfers is respected, the transfer by the domestic affiliates of US1 and US2 of the Px partnership interests to FPshp1 and FPshp2, which were treated as partnerships for U.S. tax purposes, is subject to the section 1491 excise tax unless an exception under section 1492 applies. The domestic affiliates checked the appropriate box on their Forms 926 electing to apply principles similar to the principles of section 367 to the transfer. The dates of the Forms 926 were the dates of the transfer, which indicate that the forms were filed on the date of the transfer. The Forms 926 also contained attached statements explaining the application of section 367 principles to the transfers and reporting the appropriate information as required by the section 6038B regulations. Thus, it appears the taxpayers made appropriate elections under section 1492 to apply section 367 principles.

Under section 367(a)(1), the transfer of property by a U.S. person to a foreign corporation in a transfer that otherwise qualifies as a nonrecognition exchange is treated as a taxable transfer, unless an exception applies. By virtue of the section 1492(2)(B) election, the principles of section 367(a) apply to the transfers of the Px partnership interests to FPshp1 and FPshp2.

Under section 367(a)(4), the transfer of a partnership interest by a U.S. person in an exchange described in section 367(a)(1) is treated as if the U.S. person transferred its pro rata share of the assets of the partnership. A U.S. person's proportionate share of partnership property is determined under the rules and principles of section 701 through 761 and their regulations. See Treas. Reg. 1.367(a)-1T(c)(3)(ii).

Under section 367(a)(4), each domestic affiliate of US1 and US2 is treated as having transferred its pro rata share of Px's assets in a section 367(a) transfer. The taxpayers, on their Forms 926, reported the partnership as having trade or business assets, the transfer of which was not taxable under section 367(a)(3)(A). The Forms 926 did not identify any trade or business property which is taxable under section 367(a)(3)(B); such property includes inventory, accounts receivable, installment obligations, and foreign currency (assets of the type which would be normally included in Px's business).

- Transfer of Intangibles

The Forms 926 also reported that Px held operating intangibles, and the domestic affiliates of US1 and US2 made elections on the Forms 926 to treat the

transfer of the operating intangibles as a deemed sale under Treas. Reg. 1.367(d)-1T(g)(2). Intangible property is defined broadly under section 367 to include knowledge, rights, documents, and any other intangible property within the meaning of section 936(h)(3)(B). See Treas. Reg. 1.367(a)-1T(d)(5)(i). An operating intangible is defined as intangible property of a type not ordinarily licensed or otherwise transferred in transaction between unrelated parties for consideration contingent upon the licensee's or transferee's use of the property. The regulations provide examples of operating intangibles as long-term purchase or supply contracts, surveys, studies, and customer lists. See Treas. Reg. 1.367(a)-1T(d)(5)(ii).

The transfer of intangible property is generally taxable under section 367(d) as if the U.S. transferor has sold the property for annual payments which are contingent on the productivity or use of the property, over the useful life of the property (commonly referred to as deemed royalty payments). The amounts taken into account are commensurate with the income attributable to the intangible. Under the section 367(d) regulations, a U.S. transferor can elect, with respect to operating intangibles, to recognize in the year of the transfer an amount equal to the difference between the fair market value of the intangible property transferred and its adjusted basis (commonly referred to as deemed sale treatment). See Treas. Reg. 1.367(d)-1(g)(2).

The U.S. transferor makes the deemed sale election by notifying the Service of the election in accordance with section 6038B and its regulations and including the appropriate amount of gross income in a timely filed tax return for the year of the transfer. See Treas. Reg. 1.367(d)-1(g)(2). Under the section 6038B regulations, the U.S. transferor is required to list on its Form 926 the intangible property for which it is making an election under 1.367(d)-1T(g)(2). The intangible property's fair market value on the date of the transfer and a calculation of the gain required to be recognized must also be provided on the Form 926. See Treas. Reg. 1.6038B-1T(b)(2) and (d)(1)(vi), as in effect for the year of the transfer.

On the transfers to the partnerships and to FCorp1, the taxpayers, on the Forms 926, notified the Service that a deemed sale election was being made under Treas. Reg. 1.367(d)-1T(g)(2). The Forms 926 contained the fair market value and adjusted basis of the operating intangibles, as well as the gain being recognized into income. Thus, it appears the taxpayers were eligible to make the election to apply the deemed sale treatment to the operating intangibles. We note, however, that the taxpayers did not identify any other intangibles on the Forms 926 for which deemed royalty income would have been created under section 367(d). It is possible that Px's business would include intangibles such as patents, inventions, and trade names which would be subject to section 367(d).

- Foreign Branch Losses

The Px partnership also had foreign branch losses which were subject to potential recapture under section 367(a)(3)(C). Under section 367(a)(3)(C), if a U.S. person transfers the assets of a foreign branch to a foreign corporation in an exchange described in section 367(a)(1), then the transferor will recognize gain equal to the sum of the losses (both capital and ordinary) which were incurred by the foreign branch before the transfer and for which a deduction was taken by the taxpayer. The amount of loss that is recaptured as income is limited by the gain that would have been recognized on a taxable sale of the assets (including intangible assets) of the foreign branch. See Treas. Reg. 1.367(a)-6T(c)(2)&(3).

Under Treas. Reg. 1.367(a)-6T(e), the amount of foreign branch losses that was previously deducted is reduced by the following amounts before they are recaptured as income under section 367(a)(1)(C):

- the amount recognized under section 904(f)(3) on account of the transfer;
- any taxable income of the foreign branch recognized through the close of the taxable year of the transfer; and
- any gain recognized pursuant to section 367(a)(1) upon the transfer of the assets of the foreign branch to the foreign corporation.

As discussed immediately below, the amount recognized under section 904(f)(3) by the affiliates of US1 on the transfer of the Px interests is \$gg (\$dd on the transfer of tangible business assets and \$ff on the transfer of operating intangibles). The amount of foreign branch losses previously deducted by the affiliates of US1 is \$bb, which is less than the amount recognized under section 904(f)(3). Hence, the foreign branch losses are reduced in their entirety by the section 904(f)(3) amounts and are not recaptured as income under section 367(a)(3)(C). See Treas. Reg. 1.367(a)-6T(e)(3).

Section 904(f)(3) Issues

Section 904(f), enacted in 1976, generally provides that if a taxpayer sustains an overall foreign loss (OFL), fifty percent of the taxpayer's foreign source income in subsequent years will be treated as U.S. source income to the extent of the amount of the OFL. See section 904(f)(1). When a taxpayer sustains an OFL in respect of a separate limitation category, it establishes an OFL account for that category, and additions are made to the OFL account to the extent an OFL reduced U.S. source taxable income. See Treas. Reg. § 1.904(f)-1(d). Under the OFL

recapture rules of section 904(f)(1) and Treas. Reg. § 1.904(f)-2, subsequently-earned foreign source income subject to the same limitation as the loss giving rise to the OFL account is recharacterized as U.S. source income until the balance in the OFL account is recaptured.

Section 904(f)(3)(A) provides that, notwithstanding certain nonrecognition rules that would otherwise apply, a taxpayer with an OFL account shall recognize foreign source income to the extent of the OFL account on the disposition of property used or held for use predominately without the United States in a trade or business (“OFL disposition rules”). Section 904(f)(3)(B)(ii) provides that income recognized solely by reason of section 904(f)(3)(A) shall have the same characterization it would have had if the taxpayer had sold or exchanged the property. For purposes of assigning the gain to a section 904(d) separate limitation category, Treas. Reg. § 1.904(f)-2(d)(1), issued in 1987, provides that the gain recognized will be treated as foreign source income subject to the same limitation as the income the property generated and the taxpayer’s OFL account will be recaptured accordingly. In the case of a disposition in which foreign source gain would otherwise be recognized irrespective of section 904(f)(3), Treas. Reg. § 1.904(f)-2(d)(3) provides that, if the taxpayer has a balance in its OFL account after applying the OFL recapture rules of section 904(f)(1), an additional portion of the OFL account shall be recaptured in an amount that is the lesser of (i) the remaining balance in the OFL account, or (ii) the entire gain recognized on the disposition not previously recaptured under section 904(f)(1). Thus, the amount recaptured is recharacterized as U.S. source income and the OFL account is reduced accordingly (Treas. Reg. §1.904(f)-2(a)).

A disposition of a partnership interest is treated as a disposition subject to section 904(f)(3) if the underlying assets of the partnership are property used in a trade or business outside the United States. Such a disposition is treated for purposes of section 904(f)(3) and the regulations thereunder as a disposition of a proportionate share of the assets of the partnership. Treas. Reg. § 1.904(f)-2(d)(5)(ii).

Under section 904(d)(2)(A)(i), income constitutes passive income if it is of a kind that would be foreign personal holding company income as defined in section 954(c). Section 954(c)(1)(B)(ii), enacted in 1988, provides that gain from the sale of a partnership interest constitutes foreign personal holding company income. Thus, gain from the disposition of a partnership interest is passive income even if the underlying assets of the partnership do not generate passive income. However, both section 367(a)(4) and Treas. Reg. § 1.904(f)-2(d)(5)(ii) treat the disposition of a partnership interest as a disposition of the partnership’s assets. See also Treas. Reg. § 1.367(a)-1T(c)(3)(ii). Section 954(c)(1)(B)(ii) is therefore inapplicable

because the taxpayer is deemed to dispose of the partnership's assets, not the partnership interest. Thus, the separate limitation category to which the gain should be assigned for OFL recapture purposes is determined as if the taxpayer had disposed of the assets directly.

Thus, the US1 and US2 subsidiaries are treated under sections 367 and 904(f)(3) as disposing of their proportionate shares of Px's (i) tangible business assets, (ii) stock of foreign corporations, and (iii) operating intangibles. You have asked for advice on whether the disposition of these assets trigger OFL recapture under section 904(f)(3). The application of section 904(f)(3) to the disposition of these assets is discussed below.

- Tangible Business Assets

The transfer of tangible business assets is subject to the OFL disposition rules because it constitutes a disposition of property used in a foreign trade or business. Both US1 and US2 must recognize gain under the OFL disposition rules even if it is not otherwise required to be recognized under section 367(a)(2). The gain recognized under section 904(f)(3) and Treas. Reg. § 1.904(f)-2(d)(4) is the lesser of (i) the balance in the taxpayer's OFL account (determined in accordance with the regulations as of the end of the year of the disposition) plus the amount of any OFL that would be part of a net operating loss if gain from the disposition were not recognized, or (ii) the excess of the fair market value of the assets over their adjusted bases. Thus, US1's required recognition amount is limited to US1's built-in gain on the assets (because the gain is less than the balance of US1's OFL account).

The gain constitutes general limitation income because the assets generate general limitation income. See Treas. Reg. § 1.904(f)-2(d)(1). The taxpayer's OFL account attributable to the general limitation category must be recaptured in the amount of the gain recognized, the gain will be characterized as U.S. source income and the OFL account is reduced accordingly.

- Stock of Foreign Corporations

Under Treas. Reg. § 1.904(f)-2(d)(5)(ii), an asset can be considered property used in a trade or business even if it is a capital asset in the hands of the taxpayer. The regulations provide that stock in a corporation will be considered property used in trade or business if the stock is acquired or held to assure a source of supply for a trade or business. However, stock shall not be considered property used in a trade or business if a substantial investment motive exists for acquiring and holding the stock. The taxpayer claims that its disposition of the stock is not subject to the

OFL disposition rules because the taxpayer has a substantial investment motive for acquiring and holding the stock. Based on the facts submitted, a determination cannot be made as to whether the OFL disposition rules apply to this transfer because there is insufficient information regarding whether the taxpayer held the stock for a substantial investment motive.

- Operating Intangibles

The US1 and US2 subsidiaries elected to treat the transfer of the operating intangibles as a sale pursuant to Treas. Reg. §1.367(d)-1T(g)(2). Accordingly, the US1 and US2 groups each recognized \$ff (each group's proportionate share of the excess of the property's fair market value over their adjusted basis) in gain as U.S. source ordinary income. We understand that Exam believes that the operating intangibles transferred may have been substantially undervalued by the taxpayer and that your office is assisting Exam in developing this issue. For purposes of providing advice on the question presented, this memorandum assumes that the amounts reported by the taxpayers are correct.

In addition to being subject to section 367(d), the disposition of the intangibles is also a disposition to which section 904(f)(3) applies. At issue is whether the taxpayer's OFL account is reduced by the gain recognized even though it is characterized as U.S. source under the section 367(d) regulations.

General OFL recapture under section 904(f)(1) does not apply here because the gain recognized under Treas. Reg. §1.367(d)-1T(g)(2) is U.S. source income. However, under section 904(f)(3) and Treas. Reg. § 1.904(f)-2(d)(1), a disposition of property used in a foreign trade or business is treated as giving rise to foreign source income subject to the same general limitation category as the income produced by such property, and the taxpayer's applicable OFL account is recaptured by the amount of income recognized. Thus, for purposes of the OFL disposition rules, all dispositions of property are treated as giving rise to foreign source income (which is then recharacterized as U.S. source because of OFL recapture), even though the income may be treated as U.S. source under another provision of the Code. Here, the gain of \$ff recognized by each taxpayer on the transfer of the operating intangibles is treated under the OFL disposition rules as foreign source income. The gain is recharacterized as U.S. source income and the applicable OFL account is reduced. Although both the section 367(d) rules and the OFL disposition rules require the recognition of gain, the \$ff gain is taken into account only once in computing the taxpayer's income.

The OFL account recaptured is the account attributable to the same limitation category as the income produced by the operating intangibles. The operating

intangibles at issue here are not licensed and therefore, do not generate passive royalty income. Because, by definition, operating intangibles are intangible property that generally are not licensed or otherwise transferred between unrelated parties for consideration contingent upon the licensee's or transferee's use of the property, these intangibles are not expected to generate passive royalty income in the future. Even if the operating intangibles were sold, the gain thereon would probably not be passive income because the intangibles do not give rise to foreign personal holding company income. See section 954(c)(1)(B)(i). Because these intangibles are assets used in the taxpayer's trade or business, they generate active business income in the general limitation category. Accordingly, the \$ff gain recognized under section 367(d) is assigned to the same limitation category, and each taxpayer's OFL account in the general limitation category is reduced by the gain recognized.

The TEFRA Issue

This case may raise certain issues involving the application of the unified partnership audit and litigation procedures contained in sections 6221-6234 ("TEFRA"). The TEFRA provisions require that all partnership items be determined at the partnership level. See section 6221 of the Code. The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of subtitle A, such item is more appropriately determined at the partnership level than at the partner level. See section 6231(a)(3). Partnership items include items relating to partnership contributions, partnership distributions, and section 707(a) transactions, "to the extent that a determination of such items can be made from determinations that the partnership is required to make with respect to an amount, the character of an amount, or the percentage interest of a partner in the partnership for purposes of the partnership books and records or for purposes of furnishing information to a partner[.]" Treas. Reg. §301.6231(a)(3)-1(a)(4). Partnership items also include the legal and factual determinations that underlie the determination of such amounts. See Treas. Reg. § 301.6231(a)(3)-1(b); see also Dial v. Commissioner, 95 T.C. 1 (1990) (partnership items include components' items of affected items). Section 367(a)(4) imposes section 367(a) at the partner level and is, therefore, not itself a partnership item. However, the amount of gain and percentage interests in property transferred are determined in part at the partnership level.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

The analysis above does not question the characterization of the series of transfers described in the Forms 926 and in your submission. [REDACTED]

[REDACTED]. We view whether you seek additional field service advice as a matter within your judgment. The fact that most of Px's assets are taxable under section 904(f)(3) and section 367(d) under the taxpayer's characterization of the transactions may make this inquiry unnecessary.

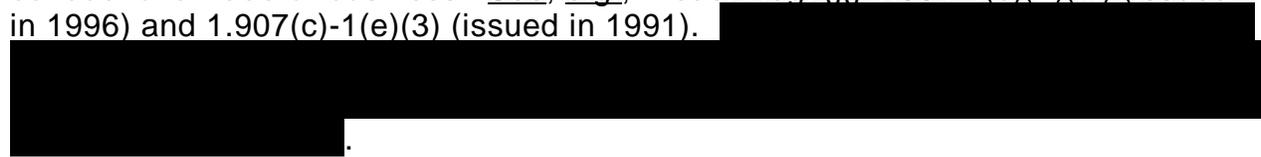
We note that section 708 applies to the transfers of the partnership interests in Px on Date 1 and the transfers of the partnership interests in FPshp1, and FPshp2 on Date 2. Section 708 generally provides that there is a termination of a partnership if 50-percent or more of the interest in the partnership's capital and profits is sold or exchanged within a 12-month period (see section 708(b)(1)(B)). For the year of the transfer, former Treas. Reg. 1.708-1(b)(1)(iv) provides that if a partnership is terminated by a sale or exchange of an interest, the partnership is deemed to distribute its properties to the purchasers (or transferees) and any remaining partners in proportion to their respective interests in the partnership properties; and, immediately thereafter, the purchasers (or transferees) and any remaining partners are treated as contributing the properties to a new partnership, either for the continuation of the business or for its dissolution and winding up.

Thus, upon the transfer of the Px partnership interests on Date 1, Px was treated as terminated under section 708, and the assets of Px were treated as distributed to FPshp1 and FPshp2 (the transferees of the Px partnership interests), which then were treated as contributing the assets to a new domestic Px partnership (with FPshp1 and FPshp2 as partners). Similarly, upon the transfer of the FPshp1 and FPshp2 partnership interests on Date 2, FPshp1 and FPshp2 were treated as terminated and their assets were distributed to FCorp1 (the transferee of the partnership interests). A further FSA may be requested on the interaction of section 708 and sections 367 and 1491. Domestic Field Service should be contacted to determine the information to be included in the submission.

[REDACTED]

Section 904(f)(3)

Although the 1987 section 904(f)(3) regulations contemplate that stock can be considered property used in a trade or business under certain limited circumstances, more recently issued regulations have taken the position that stock of a corporation shall not be considered an asset used in, or held for use in, the conduct of a trade or business. See, e.g., Treas. Reg. §§ 1.864-4(c)(2)(iii) (issued in 1996) and 1.907(c)-1(e)(3) (issued in 1991).



The TEFRA Issue

While section 367(a)(4) imposes a tax at the partner level and does not constitute a partnership item, the tax is nevertheless calculated by reference to the partner's pro rata share of the assets of the partnership. The value of those assets and a partner's pro rata share thereof are probably partnership items. As a general matter, the partnership items as stated on the partnership return are final and cannot be redetermined other than in a partnership audit (i.e. you cannot do so in an audit of an individual partner). See Roberts v. Commissioner, 94 T.C. 853, 860-862 (1990); Doe v. Commissioner, 1997-1 USTC ¶ 50,460 (10th Cir. 1997), unpublished opinion rev'g in part, T.C. Memo. 1993-543; but see Durret v. Commissioner, T.C. Memo. 1994-179, unpublished opinion modifying other issues, USTC 96-1 ¶ 50,040 (5th Cir. 1994) (opposite result where no partnership examination conducted).



If you have any further questions, please call 202-622-3860.

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