

Internal Revenue Service

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Person To Contact: _____, ID No.

Telephone Number: _____

Refer Reply To:
CC:ITA:B07
PLR-134799-07

Date:
January 25, 2008

Re: Request for Private Letter Ruling Regarding Liquidation of Taxpayer and Distribution of All of Its Assets

Legend

Taxpayer =

Town =

CFD =

State =

A =

B =

Dear

This letter responds to a letter dated July 26, 2007, and subsequent correspondence, submitted on behalf of Taxpayer, Town, and CFD, requesting a letter ruling relating to the proper federal income tax treatment of the liquidation of Taxpayer and the distribution of its assets and liabilities under sections 115, 337, 1245, and 1250 of the Internal Revenue Code.

FACTS

Taxpayer represents that the facts are as follows:

On June 5, 1998, as a result of a private letter ruling request, the Internal Revenue Service issued PLR 9836014 involving proposed transactions in which Town

would form, pursuant to State law, CFD, a community facilities district, which would purchase all the stock of Taxpayer (then known as A), then a taxable corporation, and would convert Taxpayer to a nonprofit, nonstock corporation with CFD, a political subdivision, as its sole member. In PLR 9836014, the Service ruled that, following the consummation of the proposed transactions, Taxpayer's income was excluded from gross income under the provisions of section 115(1), while the sole member of Taxpayer was CFD, and that Town, CFD, and Taxpayer will not recognize gain pursuant to section 336 or section 337 or any other Code provision upon CFD's purchase of Taxpayer's stock and the Conversion or by reason of Taxpayer's subsequent exclusion of income under section 115. In PLR 9836014, the Service, however, stated that it expressed no opinion concerning the tax treatment of future actual or constructive dispositions of assets by Taxpayer, including the application of section 1245 or section 1250. The proposed transactions described in PLR 9836014 were consummated pursuant to a binding agreement on B (prior to the date section 1.337(d)-4 of the Income Tax Regulations became effective).

Now, the proposed transaction of this letter ruling request involves the liquidation of Taxpayer and distribution of its assets to Town and the assumption of Taxpayer's liabilities by Town. Taxpayer provides water utility services to residents of certain areas of Town. Town has also maintained a separate water system, which has provided water to areas of Town not within the service area of Taxpayer's system. Although Town anticipated being able to maintain the separate existence of Taxpayer, certain difficulties and administrative expense of operating two separate water systems have caused Town to consider liquidation of Taxpayer and the distribution of all of its assets to Town. Taxpayer's amended Articles of Incorporation provide that, in the event of Taxpayer's dissolution, all of its assets, after payment of debts and obligations, will be distributed to CFD or another political subdivision of State specified by Taxpayer's Board of Directors. The plan of liquidation to be adopted by the Board of Directors provides that Taxpayer's assets and liabilities will be distributed to Town so that the two separate (water) systems may be administered as one.

RULINGS REQUESTED

Taxpayer requests that the Service issue the following rulings:

(1) The regulations issued under section 337(d) do not apply to the liquidation of Taxpayer, and

(2) Any income or loss that Taxpayer would realize upon liquidation is excluded under section 115(1).

LAW AND ANALYSIS

Ruling Request (1)

Taxpayer is a tax-exempt entity. The liquidation of Taxpayer and the distribution of its assets to Town would be a transfer of assets from a tax-exempt entity to a political subdivision. Such transactions are not covered by regulations under section 337(d).

Ruling Request (2)

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

The Service previously concluded in PLR 9836014 that Taxpayer's income is derived from its activities as a public utility and that its income accrues to the benefit of CFD, a political subdivision. The income of Taxpayer continues to be derived from its activities as a public utility.

Taxpayer's amended Articles of Incorporation provide that in the event of dissolution, all of its assets, after payment of its debts and obligations, will be distributed to CFD or "another political subdivision." In PLR 9836014, the Service held that Taxpayer's income accrued to CFD, a political subdivision. The accrual requirement of section 115(1) also will be met where the income attributable to the liquidation of Taxpayer will accrue to Town, another political subdivision.

Based on the information and representations submitted, we hold that the income of Taxpayer is derived from its activities as a public utility and will accrue upon liquidation to a political subdivision for purposes of section 115(1).

CONCLUSIONS

Based solely on the facts and representations and the relevant law and analysis set forth above, we conclude that:

(1) The regulations issued under section 337(d) do not apply to the liquidation of Taxpayer, and

(2) Any income that Taxpayer would realize upon liquidation (other than the potential depreciation recapture income discussed below) will be excludable from gross income under section 115(1).

In its letter ruling request, Taxpayer discussed the interaction of sections 115(1) and 1245 and their application to the proposed transaction described in this letter ruling

(i.e., the liquidation of Taxpayer and the distribution of its assets to Town). We discussed this issue, among others, at Taxpayer's conference of right. Specifically, the issue involves the application of the depreciation recapture rules under sections 1245 and 1250 to depreciation deductions taken by Taxpayer on its pre-acquisition assets.¹ At Taxpayer's conference of right, Taxpayer provided information that suggested that section 1245 depreciation recapture would not be pertinent to the discussion of the tax consequences upon liquidation of Taxpayer because Taxpayer would not realize any gain subject to depreciation recapture upon the distribution of the pre-acquisition assets. In its submission of additional information (following Taxpayer's conference of right), Taxpayer included a valuation report (Valuation Report) that provides a current valuation for Taxpayer's remaining pre-acquisition assets and that assigns a value to the remaining pre-acquisition assets that is less than Taxpayer's basis in such assets. Given the valuation conclusions of the Valuation Report, Taxpayer withdrew any portion of the ruling request that would apply section 115(1) to the potential depreciation recapture in the pre-acquisition assets.

Except as specifically set forth above, we express no opinion concerning the Federal income tax consequences of the proposed transaction under any other provisions of the Code and regulations thereunder or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that is not specifically covered by the above rulings. Specifically, no opinion is expressed or implied on: (i) the correctness of the analysis and conclusions of Taxpayer's Valuation Report, including the methodology used to value the assets in Taxpayer's Valuation Report and the valuations assigned to the assets in Taxpayer's Valuation Report, (ii) the interaction of section 115(1) and the depreciation recapture rules under sections 1245 and 1250 with respect to any disposition of Taxpayer's pre-acquisition assets, and (iii) the application of section 1245 or section 1250 upon any disposition of Taxpayer's pre-acquisition assets.

In accordance with the power of attorney, we are sending a copy of this letter to Taxpayer's authorized representatives. We are also sending a copy of this letter to the appropriate operating division director.

¹ The pre-acquisition assets are the depreciable assets that were owned by Taxpayer and upon which depreciation was taken by Taxpayer when it was a taxable corporation prior to the acquisition of all of its stock by CFD on B.

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

Sincerely,

KATHLEEN REED

Kathleen Reed
Chief, Branch 7
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2):

copy of this letter

copy for section 6110 purposes