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LEGEND

Parent =

State =

A =

B =

C =

D =

E =

DRE1 =

DRE2 =

DRE3 =

LLC1 =

LLC2 =

Date 1 =

Date 2 =

a =

b =

c =

d =

e =

f =

Dear :

This letter responds to a letter dated February 24, 2014, and subsequent correspondence, submitted on behalf of Parent by Parent's authorized representatives requesting rulings under § 732(f) of the Internal Revenue Code (Code).

FACTS

Parent is a publicly traded State corporation and the common parent of an affiliated group of corporations that files a U.S. consolidated federal income tax return ("Parent Consolidated Group"). The structure of the Parent Consolidated Group as it pertains to the entities relevant for purposes of this ruling request is as follows:

- Parent indirectly owns all of the membership interests in A, a State limited liability company that is classified as an association taxable as a corporation for federal tax purposes;
- Parent also wholly owns DRE1, a State limited liability company that is classified as a disregarded entity for federal tax purposes;
- DRE1 holds all the outstanding stock of B, a State corporation;
- B directly owns all the outstanding stock in each of C, a State corporation, and D, a State corporation;
- D directly owns all of the membership interests in E, a State limited liability company that is classified as an association taxable as a corporation for federal tax purposes;

- B, C, and E directly own a%, b%, and c% of the membership interests, respectively, in LLC1, a State limited liability company that is classified as a partnership for federal tax purposes;
- Collectively, B, C, and E own 100% of LLC1;
- A, B, and LLC1 directly own d%, e%, and f% of the membership interests, respectively, in LLC2, a State limited liability company that is classified as a partnership for federal tax purposes; and
- Collectively, A, B, and LLC1 own 100% of LLC2.

Some of the trade or business assets contributed to LLC1 and LLC2 by their initial partners had a fair market value different from their partners' adjusted tax basis in the assets at the time of contribution ("section 704(c) property").

The partnership agreements of LLC1 and LLC2 provide that each partnership will liquidate in accordance with each partner's positive capital account. On Date 1, B, C, and E amended LLC1's partnership agreement to provide that, in the event of a deemed or actual liquidation of each partnership, each partner is entitled to receive:

[F]irst, any remaining assets of the Company that such Member contributed, or as a successor in interest is considered to have contributed (consistent with section 1.704-3(a)(7) of the Treasury Regulations), to the Company as a capital contribution ("Member Directly Contributed Assets"), and any remaining assets that are treated as substituted basis property under section 1.704-3(a)(8)(i) of the Treasury Regulations as a result of having been received by the Company in an exchange or series of exchanges in which no gain or loss was recognized, or any installment note received by the Company in exchange for any of the foregoing property as provided in section 1.704-3(a)(8)(ii) of the Treasury Regulations ("Substituted Basis Assets" together with the Member Directly Contributed Assets, the "Member Contributed Assets"), in each case prioritizing that portion of Member Contributed Assets that constitute property subject to section 704(c) of the Internal Revenue Code of 1986, as amended, at the time of such distribution before other Member Contributed Assets, to the extent of any amounts due to such Member with respect to the Interests held by such Member, and

[S]econd, any remaining assets of the Company that are not Member Contributed Assets, to the extent of any remaining amounts due to such Member in respect of the Interests held by such Member.

On Date 1, A, B, and LLC1 amended LLC2's partnership agreement to include a similar provision.

PROPOSED TRANSACTIONS

Pursuant to a plan to simplify the organizational structure of the Parent Consolidated Group, the following transactions are planned to be executed:

- (1) LLC2 will elect to be treated as an association taxable as a corporation for federal tax purposes under § 301.7701-3 of the Procedure and Administration Regulations (the “LLC2 Incorporation”). As a result of this election, LLC2 will be treated for federal tax purposes as contributing all of its assets and liabilities to a new corporation (“NewCo”) in exchange for stock in NewCo and then distributing the stock to its partners in liquidation of their membership interests.
- (2) On the same day, following the LLC2 Incorporation:
 - (i) D will convert into a State limited liability company (as converted, DRE2) and as a result will become classified as a disregarded entity for federal tax purposes, and E will merge with and into DRE2.
 - (ii) Simultaneously with the merger of E with and into DRE2, C will convert into a State limited liability company (as converted, DRE3) and as a result will become classified as a disregarded entity for federal tax purposes.
 - (iii) As a consequence of steps (i) and (ii), LLC1 will be wholly owned by B and as a result will become classified as a disregarded entity for federal tax purposes (the “LLC1 Termination”).

REPRESENTATIONS

- The fair market values of the assets of LLC1 and LLC2, respectively, will exceed the amount of their respective liabilities at the time of the LLC2 Incorporation and the LLC1 Termination;
- LLC2 has had a valid § 754 election in effect since its formation;
- At the time of the LLC2 Incorporation and the LLC1 Termination, Parent, A, B, C, D, and E will be members of the same affiliated group under § 1504(a);
- Immediately following the LLC1 Termination, for purposes of § 732(f), A and B will be treated as owning at least 80 percent of the total voting power and total value of the stock of NewCo under § 1504(a)(2);

- At the time of the LLC2 Incorporation, the aggregate outside basis of the partners' interests in LLC2 will be equal to the aggregate inside basis of LLC2's assets taking into account the partners' relative § 743(b) adjustments, if any;
- At the time of the LLC1 Termination, the aggregate outside basis of the partners' interests in LLC1 will be equal to the aggregate inside basis of LLC1's assets taking into account the partners' relative § 743(b) adjustments, if any;
- The deemed contribution by LLC2 of all its assets and liabilities to NewCo in exchange for stock in NewCo in the LLC2 Incorporation will qualify as an exchange under § 351 in which there will be no boot received and no gain or loss recognized;
- Section 362(e)(2) will not apply to the deemed contribution by LLC2 of all its assets and liabilities to NewCo because the aggregate basis of the assets deemed contributed to NewCo will be less than their fair market value at the time of the LLC2 Incorporation. (In any event, LLC2 and NewCo will make a protective § 362(e)(2)(C) election as permitted and in the manner prescribed by § 1.362-4(d) of the Income Tax Regulations to reduce the basis of the NewCo stock deemed received by LLC2 in lieu of reducing the basis of the property deemed contributed to NewCo in the LLC2 Incorporation if it were determined to be subject to § 362(e)(2).);
- The conversion of C into a State limited liability company and as a result its classification as an entity that is disregarded as an entity separate from B, taken together with Parent's contribution of all its C stock to B on Date 2, is intended to qualify as a tax-free reorganization under § 368;
- The conversion of D into a State limited liability company and as a result its classification as an entity that is disregarded as an entity separate from B, taken together with Parent's contribution of all its D stock to B on Date 2, is intended to qualify as a tax-free reorganization under § 368;
- Taken together with the steps contemplated to be a tax-free reorganization of D described above, the merger of E with and into DRE2 is intended to qualify as a tax-free reorganization under § 368; and
- At the time of the LLC2 Incorporation and the LLC1 Termination, each partner's relative positive capital account will equal or exceed the value of that partner's Member Contributed Assets that constitute section 704(c) property at the time of such incorporations, and each partner in LLC1 and LLC2 will receive all its Member Contributed Assets that constitute section 704(c) property upon the liquidation of LLC1 and LLC2 under the liquidation provisions in LLC1's and LLC2's partnership agreements.

RULINGS REQUESTED

Parent requests the following rulings:

- (1) Section 732(f) does not apply to the distribution of NewCo stock to the corporate partners of LLC2 in the liquidation of LLC2 that is deemed to occur as a result of the LLC2 Incorporation.
- (2) Section 732(f) does not apply to the distribution of NewCo stock to the corporate partners of LLC1 in the liquidation of LLC1 that is deemed to occur as a result of the LLC1 Termination.

LAW AND ANALYSIS

RULING REQUEST # 1

Section 301.7701-3(g)(1)(i) provides that if an eligible entity classified as a partnership elects under § 301.7701-3(c)(1)(i) to be classified as an association, the entity will be treated as contributing all of its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter, the partnership liquidates by distributing the stock of the association to its partners.

Section 351 provides that no gain or loss is recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in the corporation and immediately after the exchange the person or persons are in control (as defined in § 368(c)) of the corporation.

Section 358(a)(1) provides, in part, that in the case of an exchange to which § 351 applies, the basis of the property permitted to be received under § 351 without the recognition of gain or loss is the same as that of the property exchanged decreased by the fair market value of any other property (except money) received by the taxpayer, decreased by any liabilities assumed by the corporation, and increased by the amount of gain to the taxpayer which was recognized on the exchange.

Section 1.704-3(a)(8)(i) provides that if a partnership disposes of section 704(c) property in a nonrecognition transaction the substituted basis property is treated as section 704(c) property with the same amount of built-in gain or loss as the section 704(c) property disposed of by the partnership. The allocation method for the substituted basis property must be consistent with the allocation method chosen for the original property. If a partnership transfers an item of section 704(c) property together with other property to a corporation under § 351, in order to preserve that item's built-in gain or loss, the basis in the stock received in exchange for the section 704(c) property

is determined as if each item of section 704(c) property had been the only property transferred to the corporation by the partnership.

Section 732(b) provides that the basis of property (other than money) distributed by a partnership in liquidation of the partner's interest is an amount equal to the adjusted basis of the partner's interest in the partnership reduced by any money distributed in the same transaction.

Section 732(f)(1) provides that if (A) a corporation ("corporate partner") receives a distribution from a partnership of stock in another corporation ("distributed corporation"), (B) the corporate partner has control of the distributed corporation immediately after the distribution or at any time thereafter, and (C) the partnership's adjusted basis in the stock immediately before the distribution exceeded the corporate partner's adjusted basis in the stock immediately after the distribution, then an amount equal to the excess shall be applied to reduce (in accordance with § 732(c)) the basis of property held by the distributed corporation at such time (or, if the corporate partner does not control the distributed corporation at such time, at the time the corporate partner first has control).

When LLC2 elects under § 301.7701-3 to be treated as an association taxable as a corporation for federal tax purposes, LLC2 will be treated as contributing all of its assets and liabilities to NewCo in exchange for NewCo stock. Generally, the basis LLC2 would take in the NewCo stock would be equal to LLC2's aggregate basis in the transferred properties, reduced by any liabilities assumed by NewCo. Section 1.704-3(a)(8)(i) provides a special rule when a partnership transfers section 704(c) property to a corporation. Under that section, LLC2's § 351 exchange includes two separate exchanges. In the first exchange, LLC2 is treated as contributing each item of section 704(c) property to NewCo in exchange for substituted basis property that is treated as section 704(c) property with the same amount of built-in gain or loss as the section 704(c) property. This exchange preserves the built-in gain or loss attributable to LLC2's section 704(c) property with respect to A, B, and LLC1. In the second exchange, LLC2 is treated as exchanging property other than section 704(c) property for NewCo stock.

After these exchanges, LLC2 will be treated as distributing the NewCo stock to A, B, and LLC1 in liquidation of their interests in LLC2. Under LLC2's partnership agreement, as amended on Date 1, A, B, and LLC1 will be treated as first receiving substituted basis property that reflects the section 704(c) property that they (or their predecessors) had contributed to LLC2, and, if necessary, other portions of NewCo stock that contain no § 704(c) characteristics of any partner. Taking into account any § 743 adjustments, the basis that A, B, and LLC1 will each take in the distributed NewCo stock after the LLC2 Incorporation should equal A, B, and LLC1's outside basis in each of their partnership interests in LLC2 before the LLC2 Incorporation.

RULING REQUEST # 2

In Rev. Rul. 84-111, 1984-2 C.B. 88, situation 3, the partners of Z transferred their partnership interests in Z to newly-formed corporation T in exchange for all the outstanding stock of T. Z then terminates under § 708(b)(1)(A) as a result of being wholly owned by T, and all of Z's assets and liabilities became assets and liabilities of T. The steps taken by Z and the partners of Z were part of a plan to transfer the partnership operations to a corporation organized for valid business reasons in exchange for its stock and were not devices to avoid or evade recognition of gain. T's basis for the assets received in the transaction equals the basis of the partners in their partnership interests allocated in accordance with § 732(c).

In Rev. Rul. 99-6, 1999-1 C.B. 432, situation 1, A and B are equal partners in the AB partnership. A sold A's entire interest in the AB partnership to B. B's purchase of A's interest in the AB partnership resulted in a termination of the partnership under § 708(b)(1)(A). For purposes of determining the tax treatment to B, AB partnership is deemed to make a liquidating distribution of all of its assets equally to A and B, and following this distribution, B is treated as acquiring the assets deemed to have been distributed to A in liquidation of A's partnership interest. As a result, B holds all of the assets formerly held by the AB partnership.

The LLC1 Termination results in the termination of LLC1 under § 708(b)(1)(A) because its membership is reduced to one member, B. Applying the principles of Rev. Rul. 84-111, situation 3, and Rev. Rul. 99-6, situation 1, from B's perspective the following is deemed to occur: LLC1 is deemed to make a liquidating distribution of all of its assets to B, C and E. Under LLC1's partnership agreement, as amended on Date 1, B, C, and E will first receive any section 704(c) property and substituted basis property that reflects the section 704(c) property that they (or their predecessors) had contributed to LLC1, and, if necessary, other non-section 704(c) property. As a result, B, C, and E will receive NewCo stock that has the same built-in gain or loss as the section 704(c) property that they (or their predecessors) contributed to LLC1. Taking into account any § 743 adjustments, the basis that B, C, and E will each take in the distributed NewCo stock after the LLC1 Termination should equal B, C, and E's outside basis in each of their partnership interests in LLC1 before the LLC1 Termination. Following this distribution, B is treated as acquiring the assets deemed to have been distributed to C and E in liquidation of C and E's partnership interests.

CONCLUSION

Based on the facts submitted and representations made, we conclude that § 732(f) does not apply to the deemed distribution of NewCo stock to the corporate partners of LLC2 in the LLC2 Incorporation, nor to the deemed distribution of NewCo stock to the corporate partners of LLC1 in the LLC1 Termination, because the requirement of § 732(f)(1)(C) is not met.

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of the transactions above under any other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects from, any transaction that the above rulings do not specifically cover.

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.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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 request for rulings, it is subject to verification on examination.

Sincerely,

Holly Porter
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthrough & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes