

Internal Revenue Service

Department of the Treasury

Number: **200214016**
Release Date: 4/5/2002
Index Number: 702.00-00; 704.00-00
708.01-00; 721.00-00
722.00-00; 723.00-00
761.00-00; 331.00-00
336.00-00; 7701.02-00
38.00-00; 1396.00-00

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Refer Reply To:
CC:PSI:B01-PLR-145455-01
Date:
December 21, 2001

LEGEND

- LLC =
- A =
- B =
- C =
- D =
- Date 1 =

- W =
- X =
- Y =
- Z =

Agreement =

Dear :

This responds to your letter dated August 21, 2001 and subsequent correspondence requesting rulings on behalf of LLC, A, B, C, and D (the Entities) regarding the classification of LLC and the federal tax consequences of a planned state law merger of A into LLC, with LLC surviving, followed by a liquidation of A's two corporate shareholders, B and C, and the further transfer of membership interests in LLC from C's shareholders to D.

FACTS

It has been represented that on Date 1, LLC was formed under state W's Limited Liability Company Act (the Act). LLC has Class A membership interests and Class B membership interests. It has been represented that all of the Class A membership interests represent Y% of the LLC, and all of the Class B membership interests represent Y% of the LLC. The Class A members will collectively be allocated Y% of the LLC's profits and losses and the Class B members will collectively be allocated Y% of the LLC's profits and losses. A is a state W subchapter C corporation. A has two classes of common stock: Class A and Class B. B owns all of the shares of A's Class A common stock, which represents a Y% ownership in A. B's stock is owned by approximately 115 individuals and entities. C owns all of the shares of A's Class B

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common stock, which represents a Y% ownership in A. C is owned by four shareholders. D is a state law LLC which has not elected to be treated as a corporation, and will be treated as a partnership under Section 301.7701-3 of the Procedure and Administration Regulations.

LLC and A will enter into Agreement and merge A into LLC. The following shall occur under the Agreement:

1. A will merge into LLC pursuant to the Act.
2. LLC will assume the liabilities and will issue to A its Class A and Class B membership interests in exchange for the assets of A.
3. A will distribute to B the Class A membership interests in exchange for the Class A common stock held by B.
4. A will distribute to C Z% of the Class B membership interests in exchange for the Class B common stock held by C.
5. In redemption and cancellation of its stock, B will distribute to its shareholders the Class A membership interests in exchange for the B outstanding common stock.
6. In redemption and cancellation of its stock, C will distribute to its shareholders all of its Class B membership interests in exchange for the C outstanding common stock.
7. The shareholders of C will contribute all of their Class B membership interests to D in exchange for membership interests in D.

Simultaneous with the merger of A into LLC, D will contribute assets to LLC in exchange for Class B Interests constituting a X% interest in LLC. Upon completion of the transaction D will hold all of the Class B membership interests.

LAW AND ANALYSIS

Section 301.7701-3(a) of the Procedure and Administration Regulations provides, in part, that a business entity that is not classified as a corporation under section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in this section. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under section 301.7701-2(b)(2)) or a partnership. Section 301.7701-3(b)(1)(i) provides, in part, that unless a domestic eligible entity elects otherwise it is a partnership if it has two or more members.

Section 721(a) provides that neither a partner nor a partnership will recognize

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gain or loss on a contribution of assets to a partnership in exchange for a partnership interest. Section 721(b) states that section 721(a) shall not apply to gain realized on a transfer of property to a partnership that would be treated as an investment company within the meaning of section 351, if the partnership were incorporated.

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property to the partnership shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

Section 708(a) provides that for the purposes of subchapter K, an existing partnership shall be considered as continuing if it is not terminated.

Section 708(b)(1)(B) provides that for the purposes of section 708(a), a partnership shall be considered as terminated only if within a 12-month period there is a sale or exchange of 50% or more of the total interest in the partnership capital and profits.

Section 761(e) of the Code provides that for purposes of section 708, any distribution of an interest in a partnership (not otherwise treated as an exchange) will be treated as an exchange.

Section 1.708-1(b)(1)(iv) of the Income Tax Regulations provides, in part, that if a partnership is terminated by a sale or exchange of an interest, the following is deemed to occur: The partnership contributes all of its assets and liabilities to a new partnership in exchange for an interest in the new partnership; and, immediately thereafter, the terminated partnership distributes interests in the new partnership to the purchasing partner and the other remaining partners in proportion to their respective interests in the terminated partnership in liquidation of the terminated partnership, either for the continuation of the business by the new partnership or for its dissolution and winding up.

Section 1.708-1(b)(1)(ii) provides, in part, that the sale or exchange of the same partnership interest more than once in a 12-month period is counted only once.

Section 38(b)(9) provides that the amount of the current year business credit includes the empowerment zone employment credit determined under section 1396(a).

Section 1396 provides that for purposes of section 38, the amount of the empowerment zone employment credit determined under this section with respect to

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any employer for any taxable year is the applicable percentage of the qualified zone wages paid or incurred during the calendar year which ends with or within such taxable year.

Section 702(a)(7), in part, provides that in determining a partner's income tax, each partner shall take into account separately the partner's distributive share of the partnership's items of credit, to the extent provided for by regulations.

Section 704(a) provides that a partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided, be determined by the partnership agreement.

Section 1.704-1(b)(4)(ii) provides that allocations of tax credits and tax credit recapture (except for section 38 property) are not reflected by adjustments to the partners' capital accounts. Thus, these allocations cannot have economic effect under section 1.704-1(b)(2)(ii)(b)(1), and the tax credits and tax credit recapture must be allocated in accordance with the partners' interests in the partnership as of the time the tax credit or credit recapture arises. If a partnership expenditure (whether or not deductible) that gives rise to a tax credit in a partnership taxable year also gives rise to valid allocations of partnership loss of deduction (or other downward capital account adjustments) for the year, then the partners' interests in the partnership regarding the credit (or the cost giving rise to it) are in the same proportion as the partners' respective distributive shares of the loss or deduction (and adjustments). See section 1.704-1(b)(5), example 11.

CONCLUSION

Based solely upon the representations made, as of the date of the merger, we conclude that:

1. LLC is a domestic eligible entity, classified as a partnership, unless it elects otherwise under section 301.7701-3 of the regulations.
2. For federal income tax purposes, A's merger into LLC pursuant to state W law will be treated as (i) a transfer by A of its assets to LLC in exchange for LLC's assumption of A's liabilities and A's receipt of a Y% Class A membership interest and a Z% Class B membership interest, followed by (ii) a distribution of Class A membership interests to B and a distribution of Z% of the Class B membership interests to C in complete liquidation of A within the meaning of section 331. See Rev. Rul. 69-6, 1969-1 C.B. 104.
3. Provided that LLC is not an investment company under section 721(b), no gain or loss will result to A or LLC upon A's contribution of its assets to LLC in exchange for membership interests under section 721. LLC will take a carryover basis in the assets under section 723. Pursuant to

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section 722, A's basis in the membership interests received pursuant to the merger shall equal the adjusted basis of A's assets at the time of contribution.

4. Provided that D is not an investment company under section 721(b), no gain or loss shall be recognized to the shareholders of C as result of the contribution of the Class B membership interests to D in exchange for membership interests under section 721. D will take a carryover basis in the membership interests under section 723.
5. Gain or loss will be recognized to A on the distribution of property to its shareholders in complete liquidation as if the property were sold to the distributee at its fair market value. See section 336.
6. The amounts distributed by A to B in complete liquidation of A will be treated as in full payment in exchange for its shares of A stock within the meaning of section 331(a). Gain or loss will be recognized by B equal to the difference between the fair market value of the Class A membership interests received by B for its shares in A and B's adjusted basis in the shares of A. Provided that section 341(a) (relating to collapsible corporations) is not applicable and provided that the shares of A are capital assets (as defined in section 1221) in the hands of B, any gain or loss recognized will be capital gain or loss, subject to the provisions and limitations of subchapter P of Chapter 1 of the Code.
7. The amounts distributed by A to C in complete liquidation of A will be treated as in full payment in exchange for its shares of A stock within the meaning of section 331(a). Gain or loss will be recognized by C equal to the difference between the fair market value of the Class B membership interests received by C for its shares in A and C's adjusted basis in the shares of A. Provided that section 341(a)(relating to collapsible corporations) is not applicable and provided that the shares of A are capital assets (as defined in section 1221) in the hands of C, any gain or loss recognized will be capital gain or loss, subject to the provisions and limitations of subchapter P or Chapter 1 of the Code.
8. Gain or loss will be recognized to B on the distribution of property to its shareholders in complete liquidation as if the property were sold to the distributee at its fair market value. See section 336.
9. The distribution of the Class A membership interests to shareholders of B will be treated as in full payment in exchange for the shares of B stock held by its shareholders within the meaning of section 331(a). Provided that section 341(a) (relating to collapsible corporations) is not applicable and provided that the shares of B are capital assets (as defined in section

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1221) in the hands of its shareholders, any gain or loss recognized will be capital gain or loss, subject to the provisions and limitations of subchapter P of Chapter 1 of the Code.

10. Gain or loss will be recognized to C on the distribution of property to its shareholders in complete liquidation as if the property were sold to the distributee at its fair market value. See section 336.
11. The distribution of the Class B membership interests to shareholders of C will be treated as in full payment in exchange for the shares of C's stock held by its shareholders within the meaning of section 331(a). Provided that section 341(a) (relating to collapsible corporations) is not applicable and provided that the shares of C are capital assets (as defined in section 1221) in the hands of its shareholders, any gain or loss recognized will be capital gain or loss, subject to the provisions and limitations of subchapter P of Chapter 1 of the Code.
12. The transfer of the membership interests will cause a technical termination under section 708, however, the entities will not recognize gain or loss under section 721 as a result of the deemed terminations under section 1.708-1(b)(1)(iv). Under section 1.708-1(b)(1)(ii) the sale or exchange of the same partnership interest more than once in a 12-month period is counted only once.
13. Under section 1.704-1(b)(4) any empowerment zone employment credit to which LLC is entitled may be allocated to the members of LLC under the principles of section 702(a)(7) in accordance with the members' interests in the LLC as of the time the credit arises.

Except as expressly ruled upon above, no opinion is expressed concerning the federal income tax consequences of the transactions described above under any other provision of the Code.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,
Dianna K. Miosi
Chief, Branch 1
Office of the Associate Chief Counsel
Passthroughs and Special Industries

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