

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

January 7, 2003

TY:

Legend

Husband
Wife
Family Partnership
State
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Dear _____ :

Husband and Wife are U.S. citizens who file a joint federal income tax return. Husband individually owns assets consisting of cash, shares of the Family Partnership, residential real estate, and certain stocks and bonds (collectively, "Husband's Individually Owned Assets"). Wife individually owns assets consisting of residential real estate and certain stocks and bonds (collectively, "Wife's Individually Owned Assets"). Husband and Wife also own certain residential real estate as tenants-in-common (the "Jointly Owned Property"). There are more than two partners in Family Partnership.

The following transaction has been proposed regarding Husband's Individually Owned Assets, Wife's Individually Owned Assets, and the Jointly Owned Property (collectively, the "Assets"):

- (i) Husband will transfer part of Husband's Individually Owned Assets and part of his interest in the Jointly Owned Property to Wife, and Wife will transfer part of Wife's Individually Owned Assets and part of her interest in the Jointly Owned Property to Husband. Following this exchange (the Exchange), Husband will own an undivided r% interest in each of the Assets, and Wife will own an

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undivided s% interest in each of the Assets.

(ii) After the Exchange in step (i) above, Husband and Wife will contribute their respective interests in the Assets to Partnership, a limited partnership newly-formed under the laws of State (together, the "Contributions"). Under the terms of the agreement governing Partnership, Husband and Wife will be the general partners. Initially, the limited partners will be Husband and Wife. Husband and Wife will be Partnership's only partners.

(iii) Following the Contributions described in step (ii) above, Husband and Wife will each transfer his or her limited partner interest in Partnership to their respective revocable grantor trust(s).

(iv) Husband and Wife may, in the future, make gifts of some of their interests in Partnership to their children and grandchildren.

Partnership will be formed under the laws of State pursuant to a statute corresponding to the Uniform Limited Partnership Act. It is represented that at least 80 percent of the value of the Partnership assets will probably be readily marketable stocks and securities immediately after the proposed transaction.

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 721(b) provides that § 721(a) shall not apply to gain realized on a transfer of property to a partnership which would be treated as an investment company (within the meaning of § 351) if the partnership were incorporated.

Section 351(a) provides that no gain or loss will be recognized if one or more persons transfer property to a corporation solely in exchange for stock in the corporation and immediately after the exchange the transferors are in control (as defined in § 368(c)) of the corporation. Section 351(e)(1) provides that § 351(a) will not apply to a transfer of property to an investment company.

Section 1.351-1(c)(1) of the Income Tax Regulations provides, in relevant part, that a transfer of property will be considered to be a transfer to an investment company (and therefore taxable under § 351) if: (i) the transfer results, directly or indirectly, in diversification of the transferors' interests, and (ii) the transferee is (a) a regulated investment company, (b) a real estate investment trust, or (c) a corporation more than 80 percent of the value of whose assets (excluding cash and nonconvertible debt obligations) are held for investment and are readily marketable stocks or securities, or interests in regulated investment companies or real estate investment trusts.

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Section 1002 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997) (the "Act"), amends § 351(e) for transfers after June 8, 1997, in taxable years ending after such date, subject to certain transitional relief provisions. Section 1002 of the Act is intended to expand the types of assets considered in determining whether a transfer is to a transferee described in § 1.351-1(c)(1)(ii)(c) to include certain assets in addition to "readily marketable stocks or securities" and interests in RICs and REITs. However, the Act is not intended to alter the requirement of § 1.351-1(c)(1)(i) that a transfer of property will be considered to be a transfer to an investment company under § 351(e) only if the transfer results, directly or indirectly, in diversification of the transferors' interests. See S. Rep. 105-33, 105th Cong., 1st Sess. 131 (1997); H. R. Rep. 105-148, 105th Cong., 1st Sess. 447 (1997); H. R. Rep. 105-220, 105th Cong., 1st Sess. 516-17 (1997).

Under § 1.351-1(c)(5), a transfer ordinarily results in diversification of the transferors' interests under § 1.351-1(c)(1)(i) if two or more persons transfer nonidentical assets to a corporation. However, if there is only one transferor, or two or more transferors of identical assets to a newly-organized corporation, the transfer will generally be treated as not resulting in diversification.

Section 1041(a) provides, in relevant part, that no gain or loss will be recognized on a transfer of property from an individual to his or her spouse.

Here, Husband will transfer an interest in Husband's Individually Owned Assets and part of his interest in the Jointly Owned Property to Wife, and Wife will transfer an interest in Wife's Individually Owned Assets and part of her interest in the Jointly Owned Property to Husband. Following this exchange, Husband and Wife will each own a certain undivided interest in each of the Assets. Husband and Wife will then contribute their respective interests in each of the Assets to Partnership. Husband and Wife (and later revocable trusts of which Husband and Wife will be the sole owners) will be the only partners in Partnership.

Based on the foregoing, we conclude, pursuant to § 1041(a) of the Code that no gain or loss shall be recognized on the Exchange of property between Husband and Wife.

Based solely on the information submitted and on the authority set forth above, and provided that Husband and Wife are co-owners of each of the Assets immediately before the Contributions, we conclude that the Contributions are not transfers of property to a partnership that would be treated as an investment company (within the meaning of § 351) if Partnership were incorporated.

Based on the foregoing, we conclude that § 721(b) does not apply to the proposed transaction and, pursuant to § 721(a), no gain or loss will be recognized by Husband or Wife if the transaction is consummated.

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The above rulings applies only to the proposed Exchange and Contributions by Husband and Wife to Partnership. We express no opinion on the effect of any other transfer of assets to Partnership by any other transferor. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant.

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

Sincerely,

J. Charles Strickland
Senior Technician Reviewer, Branch 5
Office of Associate Chief Counsel
(Income Tax and Accounting)

Enclosures:

copy of this letter
copy for section 6110 purposes

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Based on the foregoing, we conclude that § 721(b) does not apply to the proposed transaction and, pursuant to § 721(a), no gain or loss will be recognized by Husband or Wife if the transaction is consummated.

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