Internal Revenue Service

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Legend:

X =

Y =

Z =

A =

B =

C =

LP1 =

LP2 =

LLC =

Trust =

Year 1 =

Year 2 =

Year 3 =

State =

a =

b =

c =

d =

e =

Dear :

This letter is in response to your request, dated October 7, 2005, on behalf of LP1, for a private letter ruling that: (1) Pursuant to Notice 2005-15, sections 704(c)(1)(B) and 737 of the Internal Revenue Code will not apply to the distribution of property in the proposed liquidation, and (2) Section 751(b) will not apply to the distribution of property in the proposed liquidation.

Facts

Based on the materials submitted and representations contained within, we understand the relevant facts to be as follows: In Year 1, A, an individual, and Y, A's wholly-owned S corporation, formed a limited partnership, LP1. A owned an a% limited partnership interest in LP1 and Y owned a b% general partnership interest in LP1. Also in Year 1, A and Z, another S corporation wholly-owned by A, formed another limited partnership, LP2. A owned an a% limited partnership interest in LP2 and Z owned a b% general partnership interest in LP2. Upon formation of the limited partnerships, A, Y, and Z contributed to the limited partnerships stock in X, a corporation primarily owned by A's family, which had section 704(c) built-in gain at the time of contribution. Subsequent to the formation of the limited partnerships, A transferred a c% limited partnership interest in each limited partnership to Trust, a non-grantor trust. Also, subsequent to the formation of the limited partnerships, A's children, B and C, obtained a total of a d% limited partnership interest in both LP1 and LP2. Each child always held the same percentage interest in LP1 as that child held in LP2.

In Year 2, X formed LLC as a wholly-owned limited liability company and contributed certain investment and operating assets to LLC. X then distributed all of the interests in LLC to its shareholders, including LP1 and LP2. After receiving interests in LLC, both LP1 and LP2 held an e% interest in LLC.

In Year 3, Z merged with and into Y, with Y surviving. Subsequently, LP2 merged with and into LP1, with LP1 surviving. The X stock and the LLC interests in both limited partnerships had appreciated at the time of the merger of the partnerships.

LP1 proposes to liquidate by distributing all of its assets to its partners. LP1 represents that the proposed liquidation will occur more than seven years after the formation of the partnerships and the contribution of the X stock to the limited partnerships. In addition, LP1 also represents that the ownership of the two partnerships, LP1 and LP2, was identical at the time of the merger of the partnerships. Specifically, LP1 represents that each partner had the same percentage interest in the capital, profits, losses, distributions, liabilities, and all other items of LP2 as that partner had in those items of LP1.

LP1 represents that the only hot assets that LP1 owns are those owned through LLC. The LLC interests are treated, in part, as unrealized receivables, because LLC owns some property subject to depreciation recapture under section 1245. The LLC interests will be distributed to the partners of LP1 pro rata in accordance with the partners' percentage interests in LP1.

Law and Analysis

Section 704(c)(1)(B) provides that if any property contributed to the partnership by a partner is distributed (directly or indirectly) by the partnership (other than to the contributing partner) within seven years of being contributed: (i) the contributing partner shall be treated as recognizing gain or loss (as the case may be) from the sale of the property in an amount equal to the gain or loss which would have been allocated to the partner under section 704(c)(1)(A) by reason of the variation described in section 704(c)(1)(A) if the property had been sold at its fair market value at the time of the distribution; (ii) the character of the gain or loss shall be determined by reference to the character of the gain or loss which would have resulted if the property had been sold by the partnership to the distributee; and (iii) appropriate adjustments shall be made to the adjusted basis of the contributing partner's interest in the partnership and to the adjusted basis of the property distributed to reflect any gain or loss recognized under section 704(c)(1)(B).

Section 737(a) provides that, in the case of any distribution by a partnership to a partner, the partner shall be treated as recognizing gain in an amount equal to the lesser of (1) the excess (if any) of (A) the fair market value of property (other than

money) received in the distribution over (B) the adjusted basis of the partner's interest in the partnership immediately before the distribution reduced (but not below zero) by the amount of money received in the distribution, or (2) the net precontribution gain of the partner. Gain recognized under the preceding sentence shall be in addition to any gain recognized under section 731. The character of the gain shall be determined by reference to the proportionate character of the net precontribution gain.

Section 737(b) provides that for purposes of section 737, the term “net precontribution gain” means the net gain (if any) which would have been recognized by the distributee partner under section 704(c)(1)(B) if all property which (1) had been contributed to the partnership by the distributee partner within seven years of the distribution, and (2) is held by the partnership immediately before the distribution, had been distributed by the partnership to another partner.

Notice 2005-15, 2005-7 I.R.B. 527, states that the Internal Revenue Service intends to promulgate regulations under sections 704 and 737 of the Internal Revenue Code to address the income tax consequences of distributions of property following partnership mergers. The Notice indicates that if the transferor partnership in an assets-over merger holds the contributed property with original section 704(c) gain or loss, the seven year periods in sections 704(c)(1)(B) and 737 do not restart with respect to that gain or loss as a result of the merger. The Notice also indicates that the regulations will provide that section 704(c)(1)(B) does not apply to newly created section 704(c) gain or loss in property contributed by the transferor partnership to the continuing partnership in an assets-over partnership merger involving partnerships owned by the same owners in the same proportions. In addition, Notice 2005-15 states that the regulations will provide that for purposes of section 737, net precontribution gain does not include newly created section 704(c) gain or loss in property contributed by the transferor partnership to the continuing partnership in an assets-over partnership merger involving partnerships owned by the same owners in the same proportions. In order for merging partnerships to qualify for these exceptions, each partner’s percentage interest in the transferor partnership’s capital, profits, losses, distributions, liabilities, and all other items must be the same as the partner’s percentage interest in those items of the continuing partnership.

Section 751(a) provides that the amount of money, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in a partnership attributable to (1) unrealized receivables or (2) inventory items of the partnership is considered an amount realized from the sale or exchange of property other than a capital asset.

Under section 751(b), certain distributions are treated as sales or exchanges. Section 751(b)(1) provides that, to the extent a partner receives a distribution of unrealized receivables or inventory items that have appreciated substantially in value from the partnership in exchange for all or a part of his interest in partnership property,

or the partner receives money or other property of the partnership in exchange for his interest in partnership unrealized receivables or substantially appreciated inventory, the transaction may, as provided in regulations, be treated as a sale or exchange.

Section 751(c) defines unrealized receivables as, to the extent not previously includible in income under the method of accounting used by the partnership, any rights to payment for (1) goods delivered or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or (2) services rendered or to be rendered. Section 751(c) also provides that for purposes of section 751(c) and sections 731, 732, and 741 (but not for purposes of § 736), such term also includes section 1245 property (as defined in section 1245(a)(3)).

Section 751(f) provides that in determining whether property of a partnership is- (1) an unrealized receivable, or (2) an inventory item, such partnership shall be treated as owning its proportionate share of the property of any other partnership in which it is a partner.

Section 1.751-1(b)(1)(i) of the Income Tax Regulations provides, in part, that section 751(b) applies whether or not the distribution is in liquidation of the distributee partner's entire interest in the partnership. However, section 751(b) applies only to the extent that a partner either receives section 751 property in exchange for relinquishing any part of the partner's interest in other property, or receives other property in exchange for relinquishing any part of the partner's interest in section 751 property.

Section 1.751-1(b)(1)(ii) provides, in part, that section 751(b) does not apply to a distribution to a partner which is not in exchange for his interest in other partnership property. Thus, section 751(b) does not apply to the extent that a distribution consists of the distributee partner's share of section 751 property or his share of other property.

Conclusions

Based on the materials submitted and the representations made, we conclude that the merger of LP2 into LP1 falls within the identical ownership exception set forth in Notice 2005-15. As a result, section 704(c)(1)(B) does not apply to, nor does section 737 net precontribution gain include, the newly created section 704(c) gain in the X stock and LLC interests contributed by LP2 to LP1 as a result of the merger. In addition, because the liquidation will occur more than seven years from the original contribution of the X stock to LP1 and LP2, sections 704(c)(1)(B) and 737 will not apply to the distribution of property in the proposed liquidation.

Furthermore, because the distribution of LP1's assets in liquidation of each partner's entire interest will be made in proportion to each partner's ownership interest in LP1, section 751(b) does not apply to the distribution.

Except as specifically ruled upon above, we express no opinion concerning the federal tax consequences of the facts described under any other provision of the Code or regulations.

Pursuant to the power of attorney on file with this office, a copy of this ruling will be sent to the taxpayer's representative and taxpayer's second, third and fourth representative.

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

Sincerely,

Beverly Katz
Senior Technician Reviewer, Branch 2
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

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