

**Internal Revenue Service**

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CC:PSI:2-PLR-161040-01  
Date:  
March 1, 2002

LLC =

X =

Y =

Date 1 =

\$a =

\$b =

\$c =

\$d =

\$e =

\$f =

\$g =

State =

Country =

Dear :

This is in reply to a letter dated October 31, 2001, together with subsequent correspondence, submitted on behalf of LLC, requesting a ruling that neither LLC nor X will recognize any discharge of indebtedness income under §61 of the Internal Revenue Code as a result of the following restructuring transaction.

## Facts

LLC is a State limited liability company that was organized on Date 1. LLC is treated as a partnership for federal tax purposes and is a registered broker and dealer under the Securities Exchange Act of 1934.

LLC is owned 99% by X, a banking corporation formed in Country that has a permanent establishment in the United States through its U.S. branch operations. The remaining 1% interest is owned by Y, a wholly owned U.S. subsidiary of X. LLC operates independently from X. The performance of LLC's transactions with counterparties is not guaranteed by X.

X, Y, and LLC plan to restructure LLC as a single member LLC. The purpose of the restructuring is to simplify X's corporate structure, reduce administrative costs, eliminate the need to file federal state, and local partnership tax returns for LLC, and reduce state taxes. Under the proposed restructuring, LLC will redeem Y's 1% interest by distributing cash to Y in complete redemption of its interest. LLC will terminate as a partnership for federal tax purposes, because LLC will have only one member after Y's interest is redeemed. LLC will continue its operations after the proposed restructuring.

The total value of LLC's assets is approximately \$a, and the total amount of LLC's liabilities is approximately \$b. LLC has represented that when LLC redeems Y's interest, the fair market value of LLC's assets will exceed the amount of its liabilities. LLC is required to calculate its profits and losses daily for federal income tax purposes under §475. Therefore, the bases of LLC's assets are always equal to their fair market values.

Approximately \$c of LLC's liabilities are owed to X. Of this amount, \$d is nonrecourse debt represented by three subordinated notes. LLC represents that the notes require semi-annual or annual payments of interest at a market rate, and that all interest payments are current. The remainder of LLC's debt to X (approximately \$e) consists of short-term repurchase (repo) agreements between LLC and X. LLC represents that the repurchase transactions occurred in the ordinary course of LLC's business.

Approximately \$f of LLC's assets are attributable to reverse repurchase transactions (reverse repos) with X. LLC's net liability to X arising from repos and reverse repos is approximately \$g (\$e minus \$f).

## Law

Under §61(a)(12) of the Internal Revenue Code, except as otherwise provided, gross income means all income, including income from the discharge of indebtedness. Section 1.61-12(c)(2)(ii) of the Income Tax Regulations provides that an issuer realizes

income from the discharge of indebtedness upon the repurchase of a debt instrument for an amount less than its adjusted issue price (within the meaning of § 1.1275-1(b)). The amount of discharge of indebtedness income is equal to the excess of the adjusted issue price over the repurchase price.

Section 301.7701-3(a) of the Procedure and Administration Regulations provides that a business entity not classified as a corporation under §301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes.

Under §301.7701-3(b)(1), unless the entity elects otherwise, a domestic eligible entity is classified as a partnership if it has two or more members.

Section 301.7701-3(f)(2) provides that an eligible entity classified as a partnership becomes disregarded as an entity separate from its owner when the entity's membership is reduced to one member.

Section 301.7701-2(a) provides that if a business entity with only one owner is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

Section 708(b)(1)(A) and § 1.708-1(b)(1) provide that a partnership shall terminate when the operations of the partnership are discontinued and no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

Section 752(a) provides that any increase in a partner's share of the liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by such partner of partnership liabilities, shall be considered as a contribution of money by such partner to the partnership.

Section 752(b) provides that any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

Section 1.752-1(f) provides that if, as a result of a single transaction, a partner incurs both an increase in the partner's share of the partnership's liabilities (or the partner's individual liabilities) and a decrease in the partner's share of the partnership's liabilities (or the partner's individual liabilities), only the net decrease is treated as a distribution from the partnership, and only the net increase is treated as a contribution to the partnership. Section 1.752-1(f) also provides that, generally, the termination of a partnership under § 708(b) will require that increases and decreases in liabilities associated with the transaction be netted to determine if a partner will be deemed to have made a contribution or received a distribution as a result of the transaction.

### Analysis and Conclusion

Based on the information submitted and the representations made in the ruling request, when Y's interest is redeemed, LLC will terminate as a partnership for federal tax purposes because it will have only one partner. Immediately upon termination of the partnership, 100 percent of LLC's remaining assets and liabilities will be deemed distributed to X in liquidation of the partnership. LLC represents that the fair market value of the assets deemed distributed to X as part of this deemed liquidation will exceed the amount of these liabilities and the tax basis of the assets will equal their fair market value at that time. After the distribution, LLC will be disregarded for federal tax purposes.

As the sole owner of LLC, X will receive in the deemed distribution nearly \$a in assets and approximately \$b in liabilities, including \$c of debt owed to X. Because a person cannot be both creditor and debtor, LLC's obligations to X are cancelled. The amount of discharge of indebtedness income is equal to the amount by which the issue price (adjusted for any premium or discount) of the indebtedness exceeds the amount paid on the indebtedness. Under the facts of this case, LLC is treated as paying the full issue price of the cancelled out debts. Accordingly, neither LLC nor X will realize any discharge of indebtedness income under §61 upon the termination of the partnership.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under §751(b) or any other provision of the Code. Specifically, no opinion is expressed concerning whether the liabilities discussed above are properly classified as debt or equity for federal income tax purposes.

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.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely yours,  
Matthew Lay  
Senior Technician Reviewer, Branch 2  
Office of the Associate Chief Counsel  
(Passthroughs and Special Industries)

Enclosures: (2)  
Copy of this letter  
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