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Department of the Treasury

Washington, DC 20224

Person to Contact:

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Refer Reply To:
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Date:
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Legend

LLC =

State =

Son =

Daughter =

Mother's Trust =

Son's Trusts =

Daughter's Trusts =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

Bank =

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This letter responds to a letter dated August 30, 2001, requesting a ruling on behalf of the Taxpayers under § 731(c) of the Internal Revenue Code. Specifically, the Taxpayers request a ruling regarding the application of § 731(c)(3)(B) where a distribution of marketable securities occurs, or is deemed to occur, as a result of a partnership division in which both resulting partnerships are continuing partnerships.

The information submitted discloses that LLC is a State limited liability company treated as a partnership for federal income tax purposes. LLC currently has a members: Son, with a b percent interest; Daughter, with a b percent interest ; Mother's Trust, with a c percent interest; Son's Trusts, with a d percent aggregate interest; and Daughter's Trusts, with a d percent aggregate interest (these members together with LLC constitute the "Taxpayers").

LLC's assets include marketable securities (stock in 3 public companies) with an aggregate fair market value of $e and an aggregate basis of $f. LLC also owns real property worth approximately $g through a disregarded limited liability company. In addition, LLC holds notes from outstanding loans to its members and persons related to its members totaling $h. Finally, LLC has approximately $i in cash. LLC's liabilities include $j of loans payable to its members and $k to Bank.

To avoid family dissension and to give the individual members greater influence in managing certain assets, the Taxpayers propose dividing LLC into two limited liability companies. To effect the division, LLC will first borrow an additional amount from Bank to equalize liabilities. Then LLC will transfer one-half of the securities and other assets and liabilities to a newly formed State limited liability company ("LLC 2") in exchange for all of its membership interests. Finally, LLC will distribute the membership interests in LLC 2 to Son and Son's Trusts in full liquidation of their interests in LLC, and to Mother's Trust in redemption of l percent of her interest in LLC. After the division, LLC 2 will hold one-half of the securities formerly held by LLC. Therefore, each member of LLC 2 will have the same share of built-in gain in the securities as the member had before the division.

The Taxpayers request the following ruling: For purposes of § 731(c)(3)(B)(ii), a Distributee Partner's share of net gain attributable to marketable securities "held by the partnership" immediately after the distribution of the interests in LLC 2 shall include only such Distributee Partner's share of net gain attributable to marketable securities held by LLC (and not LLC 2) immediately after such distribution.

Section 708(b)(2)(B) provides that in the case of a division of a partnership into two or more partnerships, the resulting partnerships (other than any resulting partnership the members of which had an interest of 50 percent or less in the capital and profits of the prior partnership) shall, for purposes of this section, be considered a continuation of the prior partnership.

Section 1.708-1(d)(1) of the Income Tax Regulations provides, in part, that upon the division of a partnership into two or more partnerships, any resulting partnership (as defined in § 1.708-1(d)(4)(iv)) or resulting partnerships shall be considered a continuation of the prior partnership (as defined in § 1.708-1(d)(4)(ii)) if the members of the resulting partnership or partnerships had an interest of more than 50 percent in the capital and profits of the prior partnership. Any other resulting partnership will not be considered a continuation of the prior partnership but will be considered a new partnership.

Section 1.708-1(d)(3)(i)(A) provides that in a division under the assets-over form where at least one resulting partnership is a continuation of the prior partnership, the divided partnership (as defined in § 1.708-1(d)(4)(i)) contributes certain assets and liabilities to a recipient partnership (as defined in § 1.708-1(d)(4)(iii)) or recipient

partnerships in exchange for interests in such recipient partnership or partnerships; and, immediately thereafter, the divided partnership distributes the interests in such recipient partnership or partnerships to some or all of its partners in partial or complete liquidation of the partners' interests in the divided partnership.

Section 1.708-1(d)(4)(i) provides, in part, that for purposes of § 1.708-1(d), the divided partnership is the continuing partnership which is treated, for federal income tax purposes, as transferring the assets and liabilities to the recipient partnership or partnerships, either directly (under the assets-over form) or indirectly (under the assets-up form). If the resulting partnership that, in form, transferred the assets and liabilities in connection with the division is a continuation of the prior partnership, then such resulting partnership will be treated as the divided partnership.

Section 1.708-1(d)(4)(ii) provides that for purposes of § 1.708-1(d), the prior partnership is the partnership subject to division that exists under applicable jurisdictional law before the division.

Section 1.708-1(d)(4)(iii) provides that for purposes of § 1.708-1(d), a recipient partnership is a partnership that is treated as receiving, for federal income tax purposes, assets and liabilities from a divided partnership, either directly (under the assets-over form) or indirectly (under the assets-up form).

Section § 1.708-1(d)(4)(iv) provides that for purposes of § 1.708-1(d), a resulting partnership is a partnership resulting from the division that exists under applicable jurisdictional law after the division and that has at least two partners who were partners in the prior partnership. For example, where a prior partnership divides into two partnerships, both partnerships existing after the division are resulting partnerships.

Section 731(a)(1) provides that in the case of a distribution by a partnership to a partner, gain shall not be recognized to the partner, except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

Section 731(c)(1) provides that for purposes of §§ 731(a) and 737, the term "money" includes marketable securities, and such securities shall be taken into account at their fair market value as of the date of the distribution.

Section 1.731-2(b)(1) of the regulations provides that for purposes of § 731(c)(3)(B) and § 1.731-2(b), all marketable securities held by a partnership are treated as marketable securities of the same class and issuer as the distributed security.

Section 731(c)(3)(B) provides, in part, that in the case of a distribution of marketable securities to a partner, the amount taken into account under § 731(c) shall

be reduced (but not below zero) by the excess, if any, of (i) the partner's distributive share of the net gain that would recognized if all marketable securities of the same class and issuer as the distributed securities held by the partnership were sold (immediately before the transaction to which the distribution relates) by the partnership for fair market value, over (ii) the partner's distributive share of the net gain that is attributable to the marketable securities of the same class and issuer as the distributed securities held by the partnership immediately after the transaction, determined by using the same fair market value as used under § 731(c)(3)(B)(i).

Section 731(c)(2)(B)(v) provides that the term "marketable securities" includes, except as otherwise provided in regulations, interests in any entity if substantially all of the assets of the entity consist (directly or indirectly) of marketable securities, money, or both.

Section 1.731-2(c)(3)(i) provides that for purposes of § 731(c)(2)(B)(v) and § 1.731-2, substantially all of the assets of an entity consist (directly or indirectly) of marketable securities, money, or both only if 90 percent or more of the assets of the entity (by value) at the time of the distribution of an interest in the entity consist (directly or indirectly) of marketable securities, money, or both.

To effect an assets-over form of division, LLC proposes contributing certain assets, including marketable securities, and liabilities to LLC 2 in exchange for 100 percent of the membership interests in LLC 2. Immediately thereafter, LLC will distribute the interests in LLC 2 to Son, Son's Trusts, and Mother's Trust ("Distributee Partners") in partial or complete liquidation of their interests in LLC. Consequently, LLC's partnership division will yield two resulting partnerships, LLC and LLC 2. The respective members of LLC and LLC 2 immediately after the division will have had an interest in capital and profits of the prior partnership (LLC before the division) of more than 50 percent. Therefore, we assume that each of the two resulting partnerships will be considered a continuation of the prior partnership. In addition, as the partnership that will transfer the assets and liabilities in the division, LLC should constitute the divided partnership. As the partnership that will be treated as receiving the assets and liabilities, LLC 2 should constitute the recipient partnership.

Because the term "money" includes marketable securities, LLC's distribution of the interests in LLC 2 to the Distributee Partners will have potential gain consequences under § 731(a). LLC's shares of stock in three public companies meet the definition of marketable securities under § 731(c). In addition, more than 90 percent of the value of LLC 2 will be attributable to the marketable securities, stock shares, it will receive in the division. Therefore, the membership interests in LLC 2 themselves should constitute marketable securities (in an amount equal to their fair market value on the distribution date), the distribution of which should constitute a distribution of money.

A limitation applies to the amount of the distribution of marketable securities

(membership interests) that is treated as a distribution of money. The amount of such a distribution is reduced under § 731(c)(3)(B) by a distributee partner's share of the built-in gain in the securities "held by the partnership." LLC is concerned that the "partnership" referred to in § 731(c)(3)(B) in determining the reduction amount may include both continuing partnerships, LLC and LLC 2, thereby eliminating most of the anticipated limitation on any § 731(a) gain resulting from the proposed division.

Based on the facts submitted and representations made, we conclude that for purposes of § 731(c)(3)(B)(ii), a Distributee Partner's distributive share of net gain attributable to the marketable securities "held by the partnership" immediately after the distribution of the membership interests in LLC 2 shall include only the partner's distributive share of net gain attributable to marketable securities held by LLC, not LLC 2, immediately after the distribution.

Except as specifically set forth above, we express or imply no opinion concerning the federal tax consequences of the foregoing facts. Specifically, we express or imply no opinion on whether LLC's division constitutes an assets-over form of division under § 708(b)(2)(B) or whether both LLC and LLC 2 will constitute continuing partnerships.

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Under a power of attorney on file with this office, a copy of this letter is being sent to the Taxpayers.

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 yours,
CHRISTINE ELLISON
Chief, Branch 3
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure:
Copy for section 6110 purposes
cc: