Internal Revenue Service

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Person to Contact:

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December 23, 1998

LEGEND

PRS =

LLC =

MEMBER2 =

STATE1 =

STATE2 =

D1 =

D2 =

D3 =

a =

b =

CITE1 =

This responds to your authorized representative's letter, dated December 11, 1998, and prior correspondence, requesting rulings under §§ 707 and 721 of the Internal Revenue Code and § 301.7701-3 of the Procedure and Administration Regulations concerning the proposed contribution of real estate property (the "Property") to a partnership.

FACTS AND REPRESENTATIONS

PRS is a STATE1 general partnership that began business on D1. LLC was formed under STATE2 law on D2. PRS contributed the Property to LLC in exchange for a 100 percent interest in LLC on D3.

PRS also owns 100 percent of the voting stock of MEMBER2. MEMBER2 is a STATE2 corporation organized on D2. On D3, MEMBER2 became a member of LLC pursuant to an agreement with PRS. The agreement states that PRS requested that, pursuant to STATE2 statute, MEMBER2 become a member of LLC without holding a membership interest.

Under the LLC agreement, MEMBER2 is not entitled to receive any distributions, income, gain, profit, loss, deduction, credit, or other sum from LLC. Except as noted below, MEMBER2 has no management, approval, voting, consent, or veto rights in connection with LLC. MEMBER2 may not transfer, sell, assign, hypothecate, or otherwise encumber its interest in LLC, nor may it withdraw from LLC. MEMBER2's rights are limited to approving any act by LLC: (1) to engage in any business or activity beyond its stated purpose; (2) to file a voluntary or involuntary petition for bankruptcy; (3) to voluntarily dissolve, liquidate, consolidate, or merge with any other entity; (4) to sell substantially all of LLC's assets; or (5) to amend LLC's certificate of formation, its stated purpose, or its governing agreement regarding dissolution and liquidation. MEMBER2 is also required to continue LLC's business in the event of PRS's bankruptcy. PRS paid MEMBER2 a to join LLC under these conditions.

Pursuant to CITE1, a person may be admitted to a limited liability company as a member of the limited liability company and may receive a limited liability company interest in the limited liability company without making a contribution or being obligated to make a contribution to the limited liability company. Unless otherwise provided in the limited liability company agreement, a person may be admitted to a limited liability company as a member of the limited liability company without acquiring a limited liability company interest in the limited liability company.

LLC currently owns and operates the Property, which has a fair market value of approximately b. LLC plans to contribute the Property to an unrelated partnership ("Partnership") in exchange for an interest in Partnership. In addition, LLC may receive

a cash disbursement to reimburse LLC for the capital expenses it and PRS incurred in developing the Property during the two years prior to the date of contribution. LLC represents that this cash reimbursement will not exceed the amount of capital expenditures incurred by PRS and LLC within 2 years of the date of the contribution of the Property to Partnership, the capital expenditures were incurred with respect to the Property, and the amount of the reimbursement will not exceed 20 percent of the Property's fair market value at the time of contribution.

LAW AND ANALYSIS

Section 707(a)(1) provides that if a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise provided in this section, be considered as occurring between the partnership and one who is not a partner.

Section 707(a)(2)(B) provides that if (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and (iii) the transfers when viewed together are properly characterized as a sale or exchange of property, than such transfers shall be treated either as a transaction described in § 707(a)(1) or as a transaction between two or more partners acting other than in their capacity as members of the partnership.

Section 1.707-3(a)(1) of the Income Tax Regulations provides that, except as otherwise provided, if a transfer of property by a partner to a partnership and one or more transfers of money or other consideration by the partnership to that partner are described in § 1.707-3(b)(1), the transfers are treated as a sale of property, in whole or in part, to the partnership.

Section 1.707-3(b)(1) provides that a transfer of property (excluding money or an obligation to contribute money) by a partner to a partnership and a transfer of money or other consideration (including the assumption of or the taking subject to a liability) by the partnership to the partner constitute a sale of property, in whole or in part, by the partner to the partnership only if based on all the facts and circumstances (i) the transfer of money or other consideration would not have been made but for the transfer of property; and (ii) in cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

Section 1.707-3(c)(1) provides that, if within a two-year period a partner transfers property to a partnership and the partnership transfers money or other consideration to the partner (without regard to the order of the transfers), the transfers are presumed to be a sale of the property to the partnership unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

Section 1.707-4(d) states that a transfer of money or other consideration by the partnership to a partner is not treated as part of a sale of property by the partner to the partnership under § 1.707-3(a) to the extent that the transfer to the partner is made to reimburse the partner for, and does not exceed the amount of, capital expenditures that (1) are incurred during the two year period preceding the transfer by the partner to the partnership; and (2) are incurred by the partner with respect to property contributed to the partnership by the partner, but only to the extent that the reimbursed capital expenditures do not exceed 20 percent of the fair market value of the property at the time of contribution.

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 761(a) defines partnership as including a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not a corporation or a trust or estate. A partner is a member of a partnership. Section 761(b).

Section 301.7701-2(a) provides that business entities are entities recognized for federal tax purposes that are not properly classified as trusts under § 301.7701-4 or otherwise subject to special treatment under the Code. A business entity with two or more members is classified for federal tax purposes as either a partnership or a corporation. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

Section 301.7701-3(b)(1)(ii) states that, unless it elects otherwise, a domestic eligible entity with a single owner is disregarded as an entity separate from its owner. Section 301.7701-3(a) defines an eligible entity as a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8).

The cases of Commissioner v. Tower, 327 U.S. 280 (1946) and Commissioner v. Culbertson, 337 U.S. 733 (1949), provide general principles regarding the determination of whether individuals have joined together as partners in a partnership. The primary inquiry is whether the parties intended to join together to operate a business and share in its profits and losses. The inquiry is essentially factual and all relevant facts and circumstances must be examined. Furthermore, it is federal, not state, law that controls for income tax purposes, regardless of how the parties are treated under state law.

Factors to consider in determining whether the parties intended to be a partnership include: 1) the agreement of the parties and their conduct in executing its terms; 2) whether business was conducted in the joint names of the parties; 3) whether the parties filed federal partnership returns or otherwise represented to the Service or to

persons with whom they dealt that they were joint venturers; 4) whether separate books of account were maintained for the venture; 5) the contributions, if any, which each party has made to the venture; 6) whether each party was a principal and co-proprietor, sharing a mutual proprietary interest in the net profits and having an obligation to share losses, or whether one party was the agent or employee of the other, receiving for his services contingent compensation in the form of a percentage of income; 7) the parties' control over income and capital and the right of each to make withdrawals; and 8) whether the parties exercised mutual control over and assumed mutual responsibility for the enterprise. Luna v. Commissioner, 42 T.C. 1067, 1077 (1964).

Here, LLC is not a partnership for federal tax purposes because, as evidenced by the LLC agreement, PRS and MEMBER2 did not enter into the agreement to operate a business and share profits and losses. MEMBER2 has no interest in LLC's profits or losses and neither manages the enterprise nor has any management rights other than those limited rights described above. Thus, for federal tax purposes PRS and MEMBER2 will not be treated as partners in LLC. Instead, PRS will be treated as LLC's sole owner. Because PRS is the sole owner of LLC and PRS will not elect to treat it as a separate entity for federal tax purposes, LLC will be disregarded as an entity separate from PRS. Accordingly, LLC's ownership interest in the Property will be treated as owned directly by PRS, LLC's capital expenditures to the Property will be treated as PRS's capital expenditures, and reimbursement payments made to LLC will be treated as being paid to PRS. Furthermore, PRS will be treated as transferring the Property to Partnership. Finally, the cash reimbursements paid by Partnership to PRS for capital expenditures that PRS incurred with respect to the Property during the two year period preceding the transfer of Property to the Partnership, in an amount not exceeding 20 percent of the fair market value of the Property at the time of contribution, will not cause the contribution of the Property to Partnership to be treated as a sale under § 707.

CONCLUSIONS

Based solely on the facts submitted and the representations made, we conclude that under § 301.7701-3 LLC will be disregarded as an entity separate from PRS. In addition, under § 721 PRS will not recognize gain or loss on its contribution of the Property to Partnership due to the reimbursement of capital expenditures to PRS as a result of the contribution.

Except as specifically ruled on above, no opinion is expressed or implied regarding the consequences of this transaction under any other provision of the Code. Specifically, no ruling was requested and none was provided concerning the nature of PRS's claimed capital expenditures.

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

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

Sincerely,

Signed/Daniel J. Coburn
DANIEL J. COBURN
Assistant to the Branch Chief, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs & Special Industries)

Enclosures: 2
Copy of this letter
Copy of for § 6110 purposes