A Deep Dive into Rev. Rul. 99-6 Transactions

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Agenda

Background

When does Revenue Ruling 99-6 apply?

Open Questions and Problems

Potential Approaches

Background

Background

McCauslen v. Commissioner, 45 T.C. 588 (1966) – From buyer's perspective, for holding period purposes, purchase of partnership interest that results in actual termination is treated as an asset purchase with respect to portion purchased.

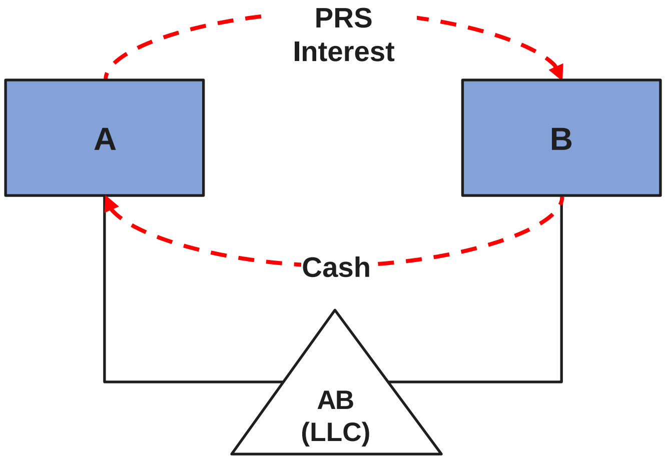
See also Rev. Rul. 67-65, Rev. Rul. 55-68, Rev. Rul. 72-172

Rev. Rul. 99-6 – appears to extend *McCauslen* rationale to all aspects of the transaction (*i.e.*, not limited to holding period issue).

Federal income tax treatment to seller: interests transfer

Federal income tax treatment to buyer: asset distribution followed by acquisition of distributed assets

Revenue Ruling 99-6, *Situation 1*



A and B are equal partners in AB, an LLC classified as a partnership. A sells its entire AB interest to B for $10,000 cash. After the sale, the business is continued by AB, which is owned solely by B.

AB terminates under section 708(b).

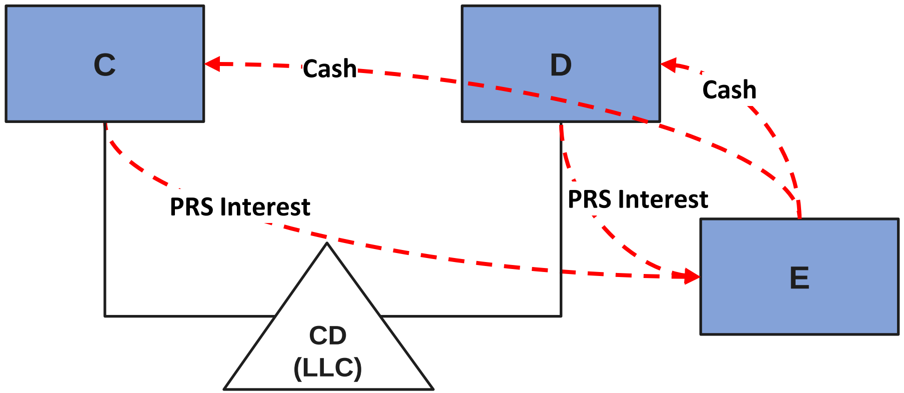
A treats the transaction as a sale of a partnership interest under section 741.

For purposes of determining the tax consequences to B, AB is deemed to make a liquidating distribution of all its assets to A and B. Immediately after, B is treated as purchasing from A the assets deemed distributed to A.

B's basis in the deemed purchased assets is equal to the purchase price for A's partnership interest. The holding period for the deemed purchased assets begins on the day immediately following the date of the sale.

Upon the termination of AB, B is considered to receive a distribution of the assets attributable to B's former interest in AB. B's holding period with respect to the assets acquired in this distribution includes the partnership's holding period for such assets under section 735(b).

Revenue Ruling 99-6, *Situation 2*



C and D are equal partners in CD, an LLC classified as a partnership. C and D sell their entire CD interests to E, an unrelated person, in exchange for $10,000 cash each. After the sale, the business is continued by CD, which is owned solely by E.

CD terminates under section 708(b).

C and D each treat the transaction as a sale of a partnership interest under section 741.

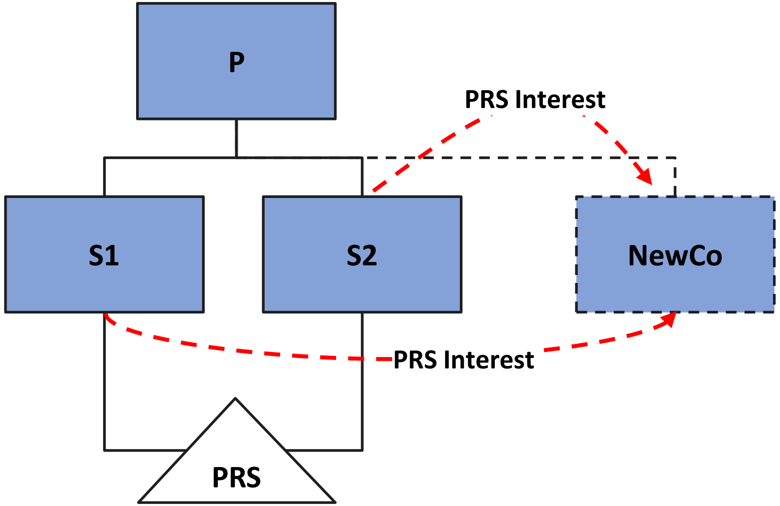
For purposes of determining the tax consequences to E, CD is deemed to make a liquidating distribution of all its assets to C and D. Immediately after, E is treated as purchasing from C and D the assets deemed distributed.

E's basis in the deemed purchased assets is equal to the purchase price for C and D's partnership interests. The holding period for the deemed purchased assets begins on the day immediately following the date of the sale.

When does it apply?

Potential problems with characterization

Nonrecognition Transactions: Example 1



P wholly owns S1 and S2. P, S1, and S2 are part of the same consolidated group.

S1 and S2 are partners in a partnership, PRS.

S1 and S2 contribute their interests in PRS to NewCo in exchange for interests in NewCo in a transaction described in Rev. Rul. 84-111, *Situation 3*, 1984-2 C.B. 88.

What is the construct of a Rev. Rul. 84-111, Sit. 3 Incorporation?

Symmetric or Asymmetric?

Symmetric

Transferors transfer partnership interests to transferee. Partnership is wholly owned by transferee as a single partner for a moment. Then partnership distributes assets and liabilities in liquidation of transferee's partnership interest.

Key considerations

Section 731

Section 707

Section 751

Section 704(c)(1)(B)/737

Section 732

Asymmetric

Transferors transfer partnership interests to transferee. *Solely from perspective of transferee*, partnership distributes assets and liabilities to transferors, and transferee acquires assets from transferors.

Key considerations

Section 731

Section 707

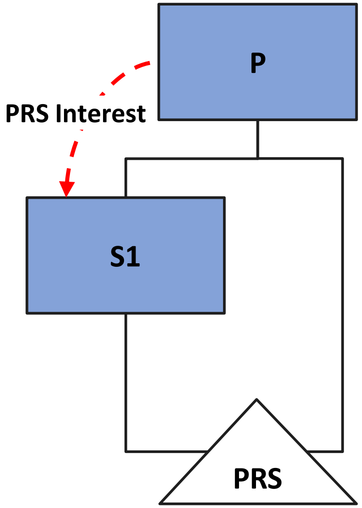
Section 751

Section 704(c)(1)(B)/737

Section 732

<u>The IRS has indicated that it believes the asymmetrical approach applies</u>. *See* Notice of Proposed Rulemaking, *Partnership Mergers and Divisions*, Fed. Reg. Vol. 65, No. 7, p. 1572.

Nonrecognition Transactions: Example 2

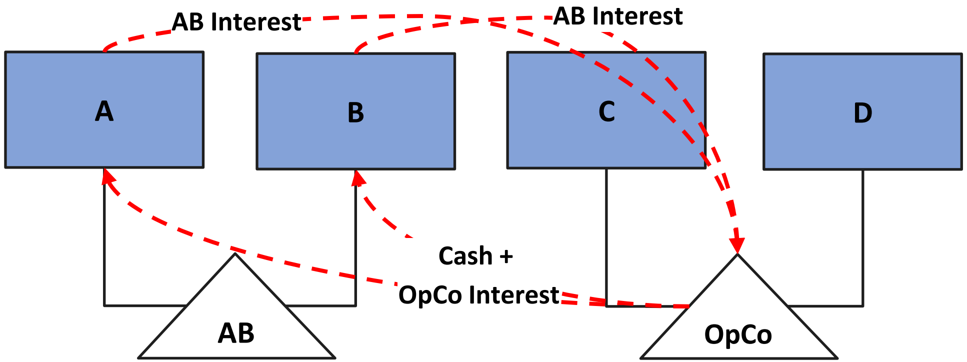


P wholly owns S1.

P and S1 are equal partners in a partnership, PRS.

P contributes its interest in PRS to S1.

99-6 or Merger?



A and B are members of AB, an LLC classified as a partnership.

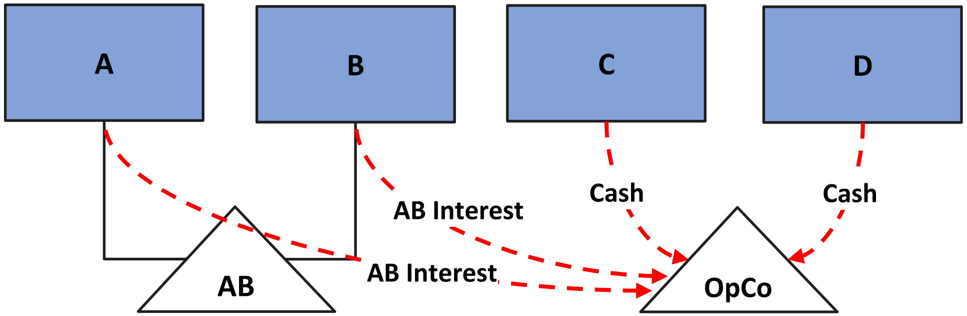
OpCo LLC is a partnership between C and D.

A and B transfer their AB interests to OpCo in exchange for cash and 60 percent of the interests in OpCo.

Which governs? Merger rules or Rev. Rul. 99-6, *Situation 2*?

What if A and B received cash and 40 percent of the interests in Opco?

99-6 or Continuation?

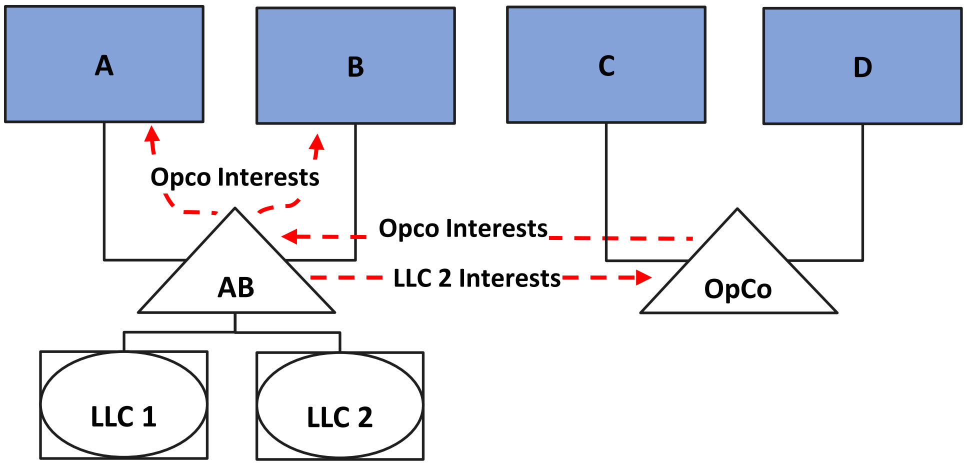


A and B are members of an LLC classified as a partnership, AB. C and D contribute cash in formation of an LLC classified as a partnership, OpCo. Immediately after, A and B transfer their AB interests to OpCo in exchange for the cash contributed by C and D and 60 percent of the interests in OpCo.

Is OpCo a continuation of AB, or does Rev. Rul. 99-6 apply?

What if A and B received only cash?

What is it?



A and B are members of an LLC classified as a partnership, AB. AB owns 100% of LLC 1 and LLC 2.

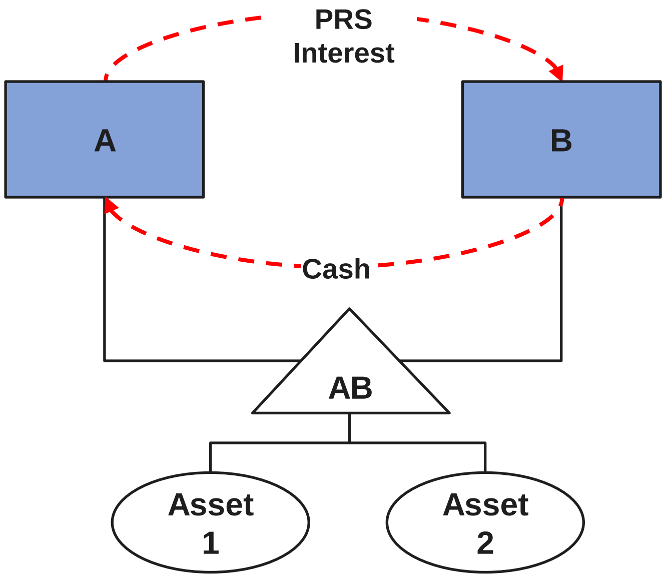
AB contributes the LLC 2 interests to OpCo in exchange for 60 percent of the OpCo interests. As part of the same plan, AB distributes the OpCo interests to A and B. As a result, A, B, C and D are each members of OpCo.

Is OpCo a continuation of AB or OpCo, or a partnership merger or division?

Asymmetrical Treatment

What are the problems and questions that may arise?

What assets are deemed distributed?
Tracking Interests

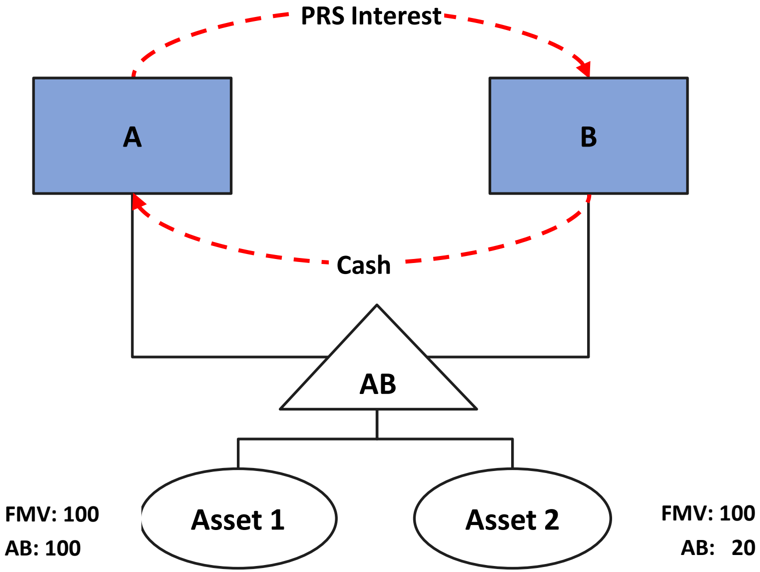


The values of A's and B's interest in partnership AB are the same. Pursuant to the AB partnership agreement, A is allocated 90 percent and B is allocated 10 percent of the profits and losses of Asset 1. B is allocated 90 percent and A is allocated 10 percent of the profits and losses of Asset 2.

A sells its entire AB interest to B for cash. After the sale, the business is continued by AB, which is owned solely by B.

Are A and B deemed to have been distributed 50 percent of each asset, or a percentage interest in each asset commensurate with their respective share of profits and losses?

What assets are deemed distributed?
Anti-Deferral Rules



Selected Issues:
Sections 704(c)(1)(B), 737, 751(b) and 731(c)

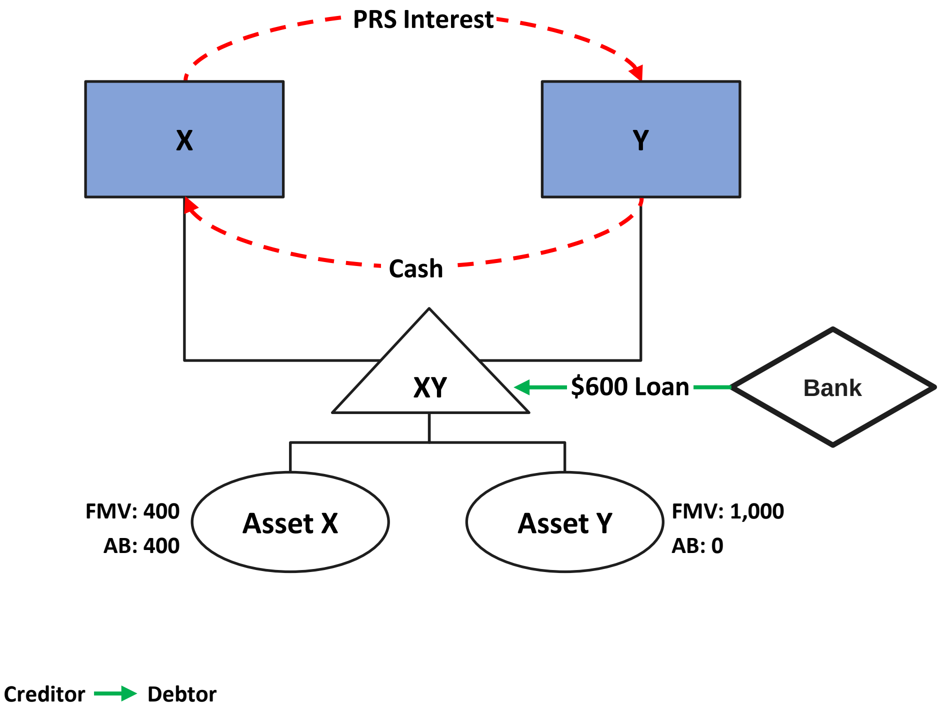
A and B are equal partners in a partnership, AB. A contributed Asset 1 with a fair market value of $100 and an adjusted basis of $100. B contributed Asset 2 with a fair market value of $100 and an adjusted basis of $20.

A sells its entire AB interest to B for cash. After the sale, the business is continued by AB which is owned solely by B.

Is each of A and B treated as receiving the property it contributed or a proportionate share of each asset?

From B's point of view, can the parties specify which assets are distributed? *Cf.* PLR 201505001. *Compare* TAM 200540010 (Oct. 7, 2005) *with* TAM 200701032 (Jan. 5, 2007).

Liabilities: How do they affect the value of assets deemed distributed?



X and Y formed partnership, XY, 10 years ago.

X contributed cash of $400, which the partnership used to purchase Asset X, a non-depreciable asset.

Y contributed Asset Y, a non-depreciable asset with a fair market value of $1,000 and an adjusted basis of $0, subject to a $600 liability that is recourse to Y for section 752 purposes.

Y purchases X's interest for cash.

How is the liability deemed assumed in the transaction?

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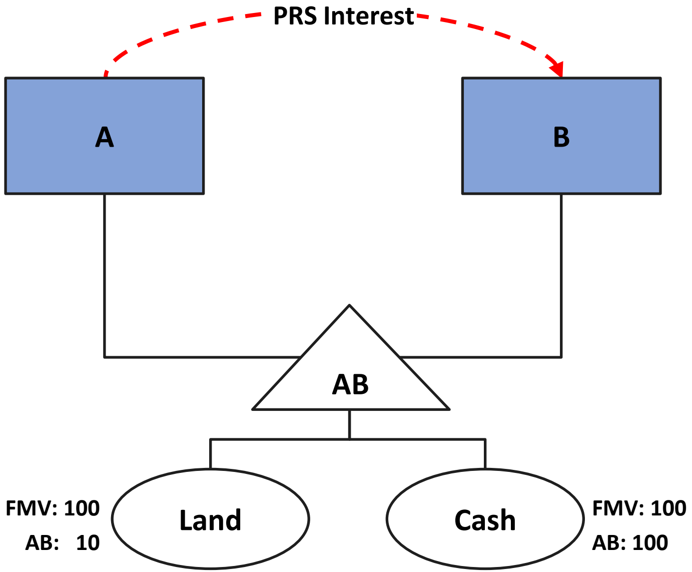
Basis Issues

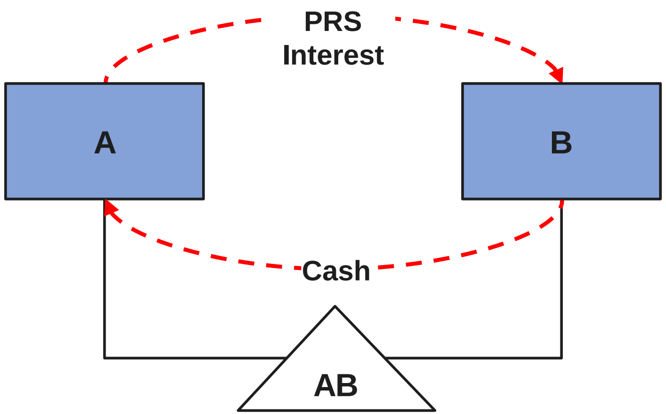


A and B are equal partners in a partnership, AB. A contributed land with a fair market value of $100 and an adjusted basis of $10. B contributed cash of $100.

B acquires A's interest in a tax-free merger.

What is the basis in the assets after the transfer?

Foreign Transferors



A and B are equal partners in a partnership, AB, which is engaged in a US trade or business. A sells its interest in AB to B.

Is the sale subject to section 1446(f) if A is a foreign person?

Priority Guidance Plan

Includes as item 8 for partnerships: Guidance on partnership terminations under Section 708.

Is any guidance anticipated?