Internal Revenue Service

Number: **200734003**
Release Date: 8/24/2007
Index Number: 721.00-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:PSI:3
PLR-124513-06
Date:
May 15, 2007

Trust =

State =

X =

Y =

Beneficiaries =

<u>a</u> =

<u>b</u> =

c =

d =

e =

f =

Dear :

This letter responds to a letter dated March 24, 2006, and subsequent correspondence, submitted on behalf of Trust requesting rulings under § 721 of the Internal Revenue Code.

FACTS

The information submitted states that Trust was formed on a under the laws of State. As of b, Trust had a security portfolio with a total asset value of approximately $c. Trust's total equities are approximately $d with a short balance of $e. Trust purchases certain securities on margin, and the current margin balance is approximately $f.

Under its terms, Trust has been divided into two equal shares for X and Y, and their respective issue. The trustees of Trust have discretion to distribute income and principal to X and Y, and their respective issue. Upon the death of X and Y, their shares are to be divided into equal shares for the benefit of their respective children, the Beneficiaries.

In order to avoid the possible imposition of a corporate trustee and in order to continue family financial and investment planning, Trust's current trustees propose the following transaction. Trust will contribute all of its assets, subject to all of its liabilities, to a new limited liability company ("Company") in exchange for interests in Company. Immediately thereafter, Trust will terminate by distributing its interests in Company to the Beneficiaries.

LAW

Section 721(a) states generally 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. However, § 721(b) provides that § 721(a) shall not apply to gain realized on a transfer of property to a partnership that would be treated as an investment company (within the meaning of § 351) if the partnership were incorporated.

Section 1.721-1(a) of the Income Tax Regulations provides that no gain or loss shall be recognized either to the partnership or to any of its partners upon a contribution of property, including installment obligations, to the partnership in exchange for a partnership interest. This rule applies whether the contribution is made to a partnership in the process of formation or to a partnership that is already formed and operating.

Section 301.7701-3(a) of the Procedure and Administration Regulations provides, in part, that a business entity that is 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 income tax purposes as provided in § 301.7701-3. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or be disregarded as an entity separate from its owner. Section 301.7701-3(b) provides a default classification for an eligible entity that does not make an election.

Section 301.7701-3(b)(1) provides that, except as provided in § 1.7701-3(b)(3), unless the entity elects otherwise, a domestic eligible entity is (i) A partnership if it has two or more members; or (ii) Disregarded as an entity separate from its owner if it has a single owner.

Section 301.7701-3(f)(2) provides, in part, that a single member entity disregarded as an entity separate from its owner is classified as a partnership when the entity has more than one member.

In Rev. Rul. 99-5, 1999-1 C.B. 434, Situation 1, LLC, which for federal tax purposes is disregarded as an entity separate from its owner, is converted to a partnership when the new member, B, purchases an interest in the disregarded entity from the owner, A. B's purchase of 50 percent of A's ownership interest in the LLC is treated as the purchase of a 50 percent interest in each of LLC's assets which are treated as held directly by A for federal tax purposes. Immediately thereafter, A and B are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

Rev. Rul. 83-75, 1983-1 C.B. 114, holds that the distribution by a trust of appreciated securities in satisfaction of its obligation to pay a fixed annuity to a charitable organization results in a taxable gain to the trust. Rev. Rul. 83-75 cites § 1.661(a)-2(f)(1) [sic] and Kenan v. Commissioner, 114 F.2d 217 (2d Cir. 1940) in determining the proper treatment of an in-kind distribution of property.

Section 1.661(a)-2(f) provides that if property is paid, credited, or required to be distributed in kind by a trust or estate, no gain or loss is realized by the trust or estate (or the other beneficiaries) by reason of the distribution, unless the distribution is in satisfaction of a right to receive a distribution in a specific dollar amount or in specific property other than that distributed.

In Kenan v. Commissioner, the trustees of a trust were directed to pay a beneficiary $5 million when the beneficiary reached age 40. The trustee paid the beneficiary partly in cash and partly in appreciated securities. The court held that the beneficiary had a general claim against the trust corpus, and the satisfaction of this general claim for an ascertainable value by a transfer of specific assets was an exchange that caused the trust to realize gain.

Section 643(e)(1) provides that the basis of any property received by a beneficiary in a distribution from an estate or trust (property distributed in kind) shall be (A) the adjusted basis of such property in the hands of the estate or trust immediately before the distribution, adjusted for (B) any gain or loss recognized to the estate or trust on the distribution.

Section 1.641(b)-3(d) provides, in part, that if a trust is considered terminated under § 1.641(b)-3 for federal income tax purposes, the gross income, deductions, and credits of the trust are, subsequent to the termination, considered the gross income, deductions, and credits of the person or persons succeeding to the property of the trust.

In this case, Trust will contribute its assets and liabilities to Company, an entity that, because it will have a single owner, will be disregarded as an entity separate from its owner. Therefore, Trust should be treated as continuing to hold the assets and liabilities it will contribute to Company. When Trust terminates upon the distribution of its interests in Company to the Beneficiaries, Trust will be treated as having distributed to the Beneficiaries its assets and liabilities, rather than the interests in Company. As a result of Trust's termination, Company will be converted from a disregarded entity to a partnership. Therefore, the Beneficiaries will be treated as contributing their respective interests in the Trust's former assets and liabilities to Company, a partnership, in exchange for ownership interests in the partnership.

Accordingly, the treatment of Trust's termination will result in each Beneficiary being treated as receiving a pro rata share of all the assets from Trust and assuming a pro rata share of all the liabilities (recourse and nonrecourse) of Trust. Each Beneficiary will then be treated as contributing all such received assets to Company, and Company will be treated as assuming all such liabilities. Therefore, if Company were incorporated, the deemed transfers to Company would not be treated as transfers of property to an investment company (within the meaning of § 351 (§ 1.351-1(c)).

CONCLUSIONS

Based on the facts and representations submitted by Trust, we conclude that the contribution to Company of all the assets of Trust, subject to Trust's liabilities, in exchange for all of the interests in Company will be disregarded for federal income tax purposes, because Company will be a disregarded entity as described in § 301.7701-3(b)(1)(ii). In addition, we conclude that the distribution of Trust's assets, subject to Trust's liabilities, to the Beneficiaries will not be a distribution in satisfaction of a right to receive a distribution in a specific dollar amount or in specific property other than that distributed, nor a distribution in satisfaction of a general claim for an ascertainable value, and therefore no gain or loss will be realized by Trust or the Beneficiaries as a result of such distribution (however, the gross income, deductions, and credits of Trust will be, subsequent to the termination, considered the gross income, deductions, and credits of the Beneficiaries succeeding to the property of the trust). Finally, we conclude that the Beneficiaries' deemed contributions to Company of Trust's assets and liabilities that the Beneficiaries will receive from Trust will be non-taxable contributions to the partnership under § 721.

Except for the specific ruling above, we express or imply no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code.

Under a power of attorney on file with this office, we are sending a copy of this letter to Company's authorized representatives.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

/s/

LESLIE H. FINLOW
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosure: copy of this letter for § 6110 purposes