

**ALI-ABA 15TH ANNUAL ADVANCED COURSE
CONSOLIDATED TAX RETURN REGULATIONS**

**September 26, 2008
Washington, DC**

**CONSOLIDATED GROUP JOINT VENTURES, INCLUDING
ONE-PARTY LIMITED LIABILITY COMPANIES (LLCs)**

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Disregarded Entities In General

Littriello v. United States

- In *Littriello v. United States*, 2005-1 U.S.T.C. ¶ 50,385, *reconsideration denied*, 96 A.F.T.R.2d 2005-5764, the U.S. District Court for the Western District of Kentucky upheld the validity of the check-the-box regulations.
- Facts – Frank Littriello was the sole member of Kentuckiana Healthcare, LLC, which had not elected to be taxed as a corporation. Kentuckiana failed to pay withholding and FICA taxes, and the IRS determined that because the entity was disregarded, Mr. Littriello was individually liable for the taxes. Mr. Littriello argued that the check-the-box regulations constituted an invalid exercise of the Treasury's authority to issue interpretive regulations under section 7805(a).

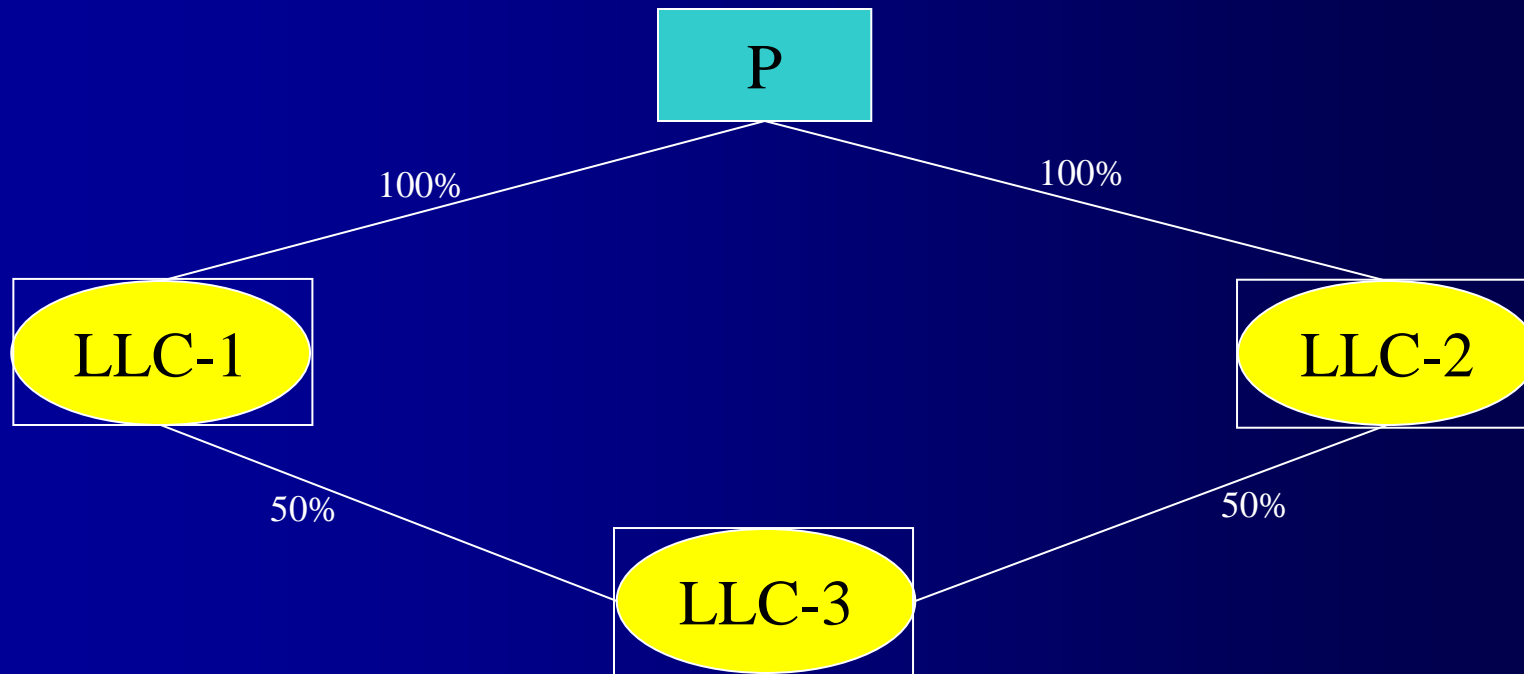
Littriello v. United States

- The court applied the two-part *Chevron* analysis in upholding the regulations' validity.
 - First, the court concluded that the statute was ambiguous, because sections 7701(a)(2) and 7701(a)(3) do not make a clear distinction between an “association,” which is treated as a corporation and a “group, pool or joint venture,” which is treated as a partnership. The growth of different state law entities has exacerbated this ambiguity.
 - Second, the court concluded that the check-the-box regulations were a permissible construction of the statute, representing a more formal version of the informally elective regime under the old *Kintner* regulations.

Littriello v. United States

- In early 2007, the Court of Appeals for the Sixth Circuit affirmed the lower court ruling. *See Littriello v. United States*, 484 F.3d 372 (6th Cir. 2007).
- In May 2007, the Court of Appeals for the Second Circuit, addressing a similar set of circumstances, also concluded that the check-the-box regulations were valid. *See McNamee v. Department of Treasury*, 488 F.3d 100 (2d Cir. 2007).
- **New Final Regulations – Treas. Reg. § 301.7701-2(c)(2)(iv) (Aug. 15, 2007)**
 - **Proposed in 2005 after the relevant tax years in *Littriello* and *McNamee*.**
 - **For wages paid on or after January 1, 2009, an entity disregarded as separate from its owner for Federal tax purposes is treated as a separate corporation for employment tax purposes and income tax withholding purposes.**
 - **Notice 99-6 will be obsoleted at such time as well.**
 - **Such an entity will be subject to (with respect to the employees of that entity) income tax withholding, FICA taxes, FUTA taxes, and employment tax deposit and reporting obligations.**
 - **The owner of such an entity will continue to be treated as self-employed (i.e., not an employee of the entity). Thus, the earnings of the entity will continue to be included in the owner's net earnings from self-employment (to the extent otherwise included).**

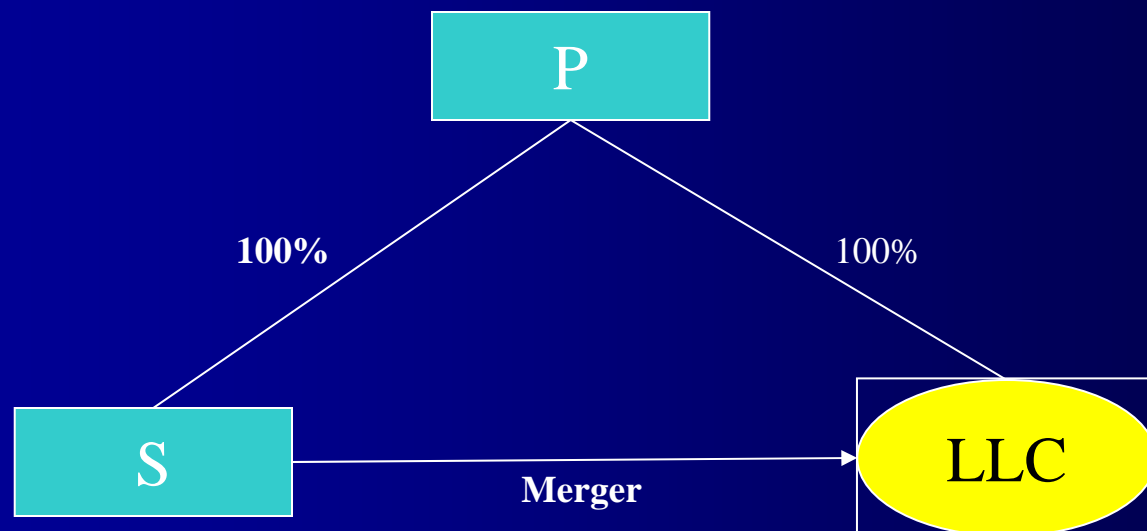
Multiple Disregarded Entities



Facts: Corporation P is the sole member of LLC-1 and LLC-2. LLC-1 and LLC-2 form LLC-3, with each taking a 50% membership interest.

Results: The assets of LLC-1, LLC-2, and LLC-3 are treated as owned directly by P. *See Rev. Rul. 2004-77.*

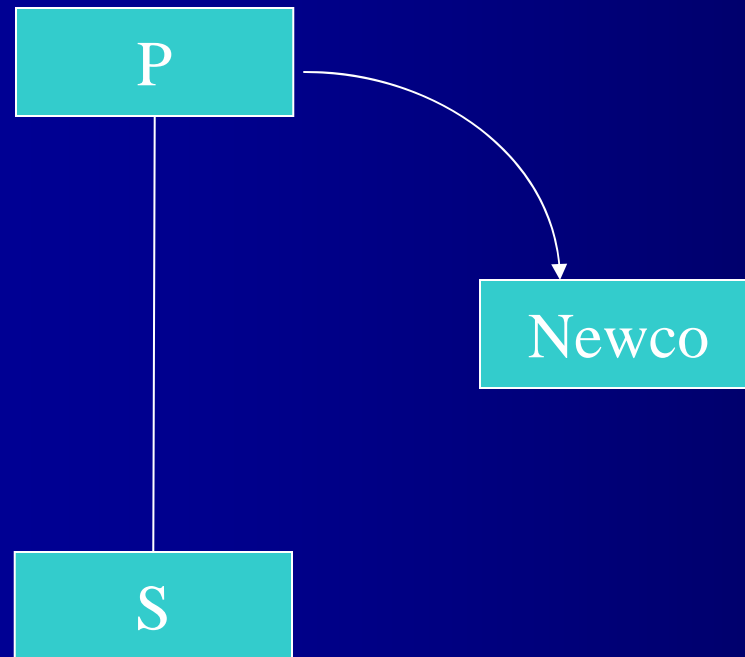
Merger of Corporation Into Single-Member LLC



Facts: Corporation P owns all of the stock of Corporation S and all of the membership interests in LLC. S is merged into LLC pursuant to Delaware Law.

Results: Although this transaction could be treated as an upstream merger, S should be treated ultimately as liquidating into P under section 332. *See* Treas. Reg. §§ 1.332-2(d), (e) ex., 1.368-2(b)(1)(ii); *see, e.g.*, PLR 9822037. 8

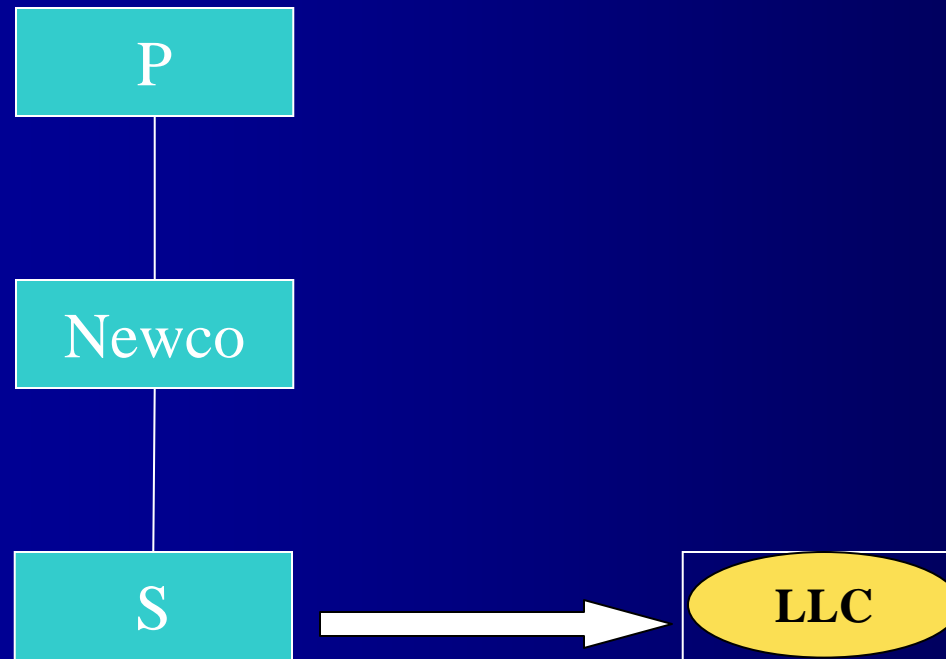
Preparing for a Joint Venture



Facts: Corporation P owns all of the stock of Corporation S and wishes to admit X as a co-owner of the S business.

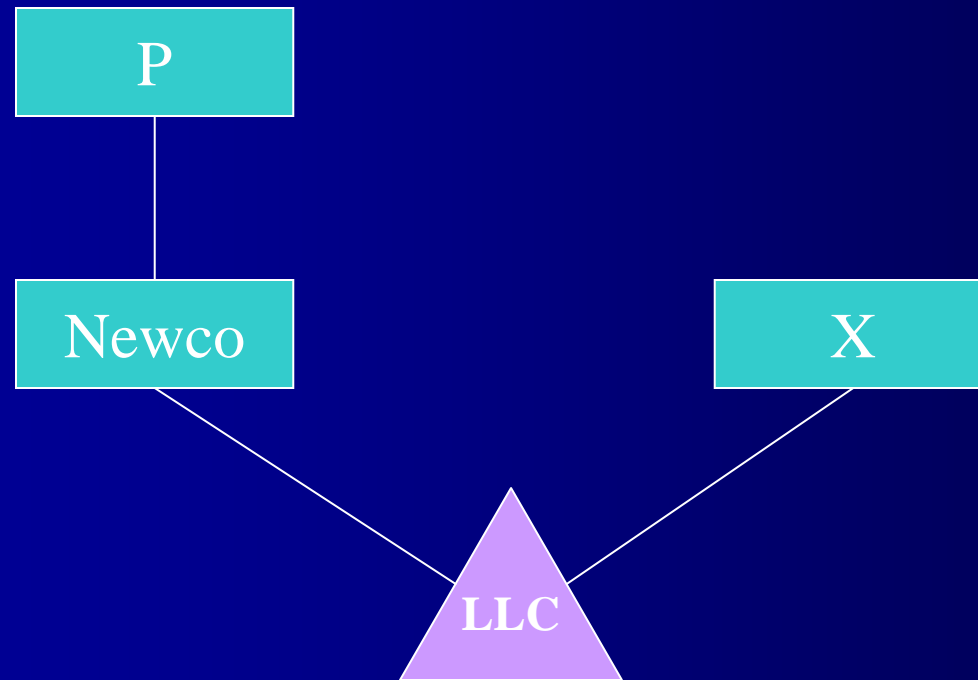
Step 1: P creates an intermediate corporation (Newco) between P and S.

Preparing for a Joint Venture



Step 2: S is converted into a single member LLC; that is, into a disregarded entity. Steps 1 and 2 should be combined into a single F reorganization (S reformed as Newco). *See Prop. Reg. § 1.368-2(m)(3)(i), (m)(5) ex. 5.*

Preparing for a Joint Venture

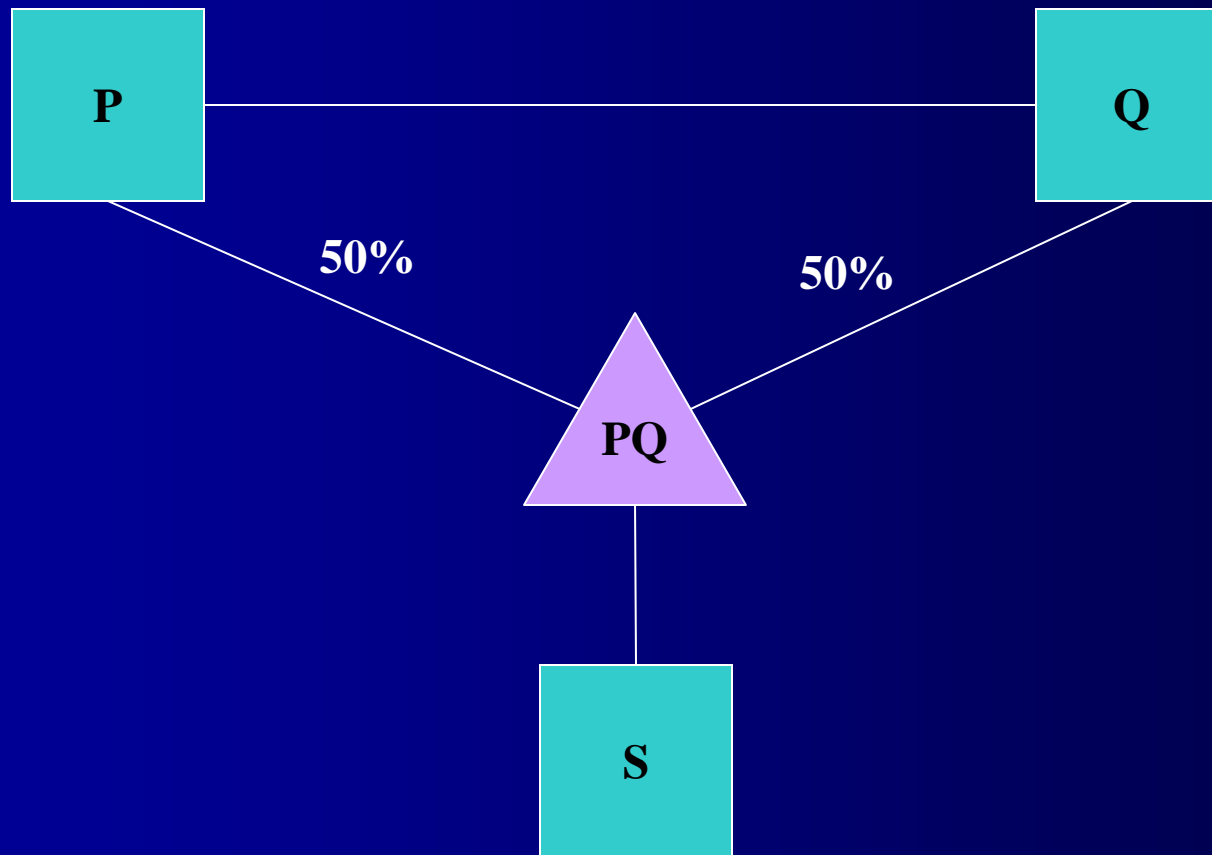


Step 3: X contributes assets to the LLC, converting it into a regarded partnership. This should be treated as a section 721 transaction for Newco as well as for X. See Prop. Reg. § 1.368-2(m)(3)(ii); Rev. Rul. 99-5 (Sit. 2).

Basic Use of Partnership Entities

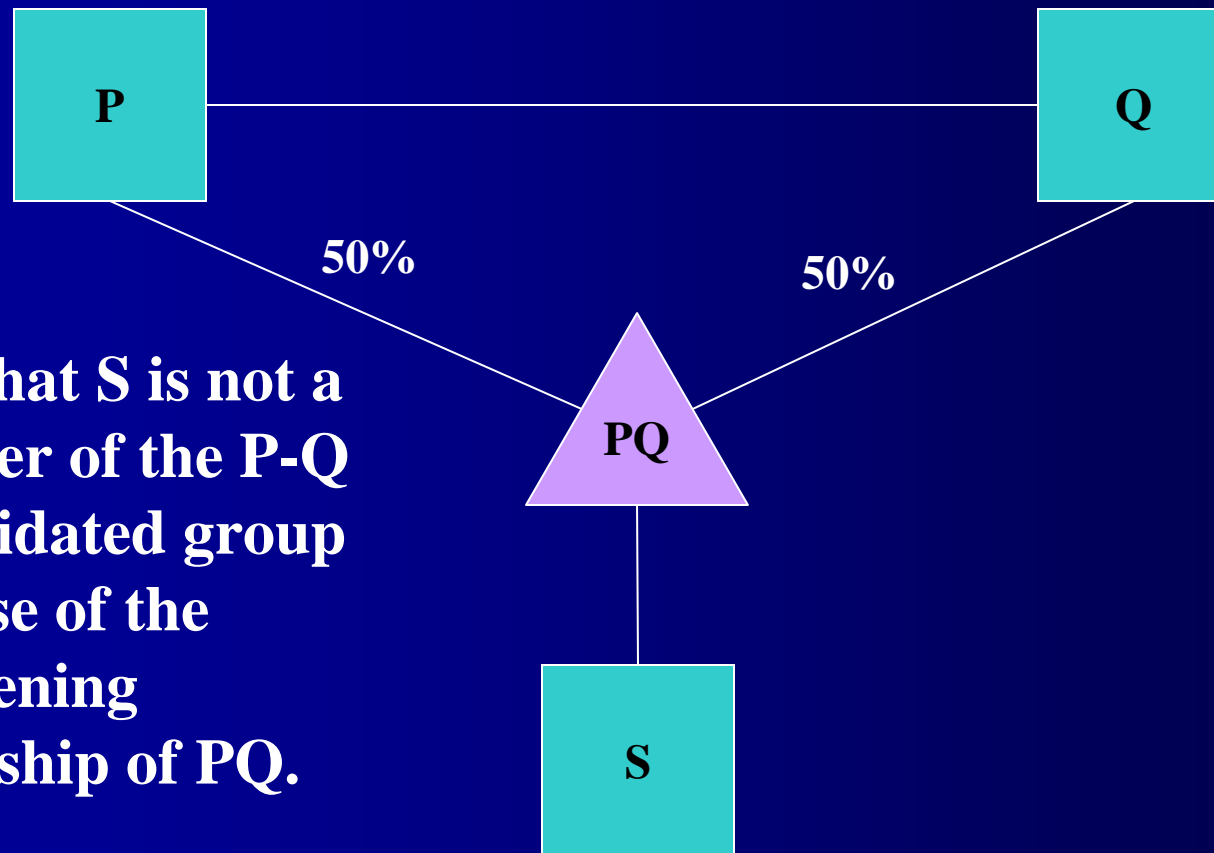
Selective Deconsolidation

P and Q are members of consolidated group



Selective Deconsolidation

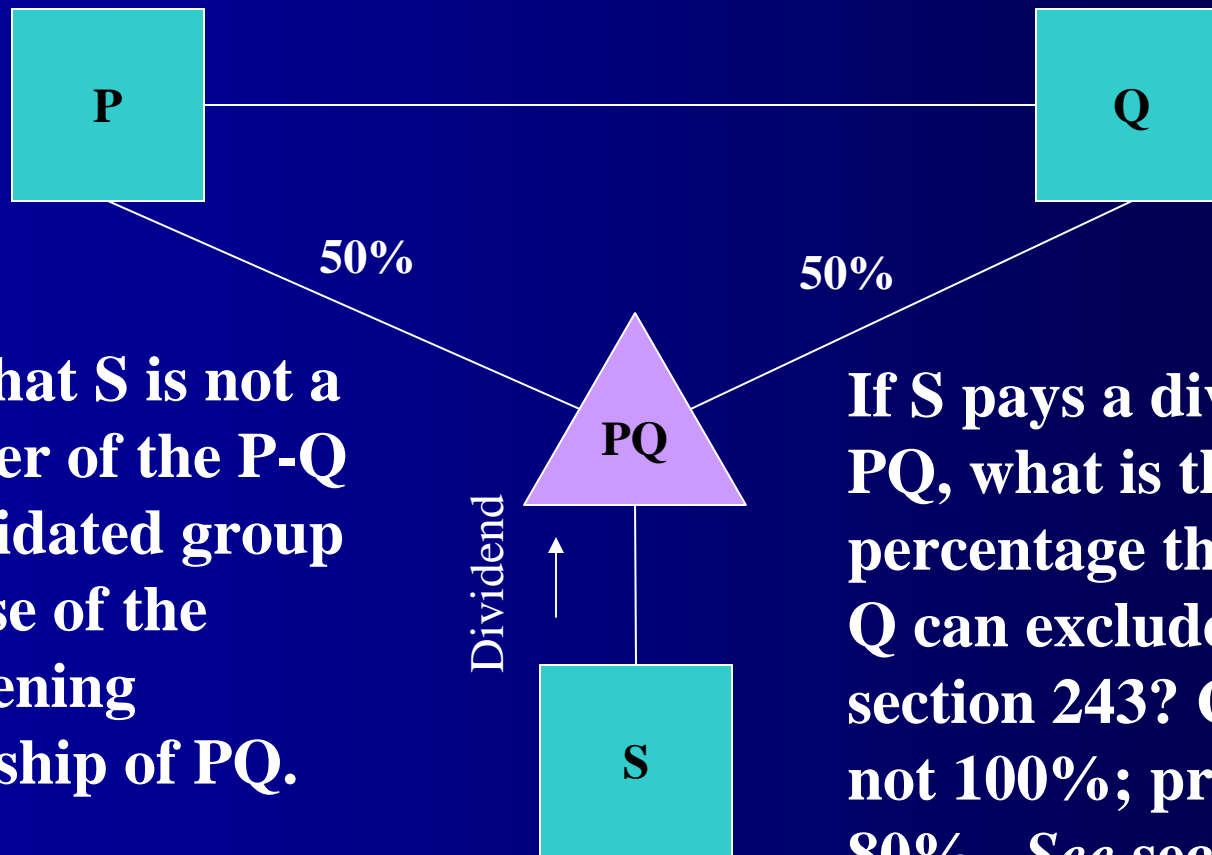
P and Q are members of consolidated group



Note that S is not a member of the P-Q consolidated group because of the intervening ownership of PQ.

Selective Deconsolidation

P and Q are members of consolidated group

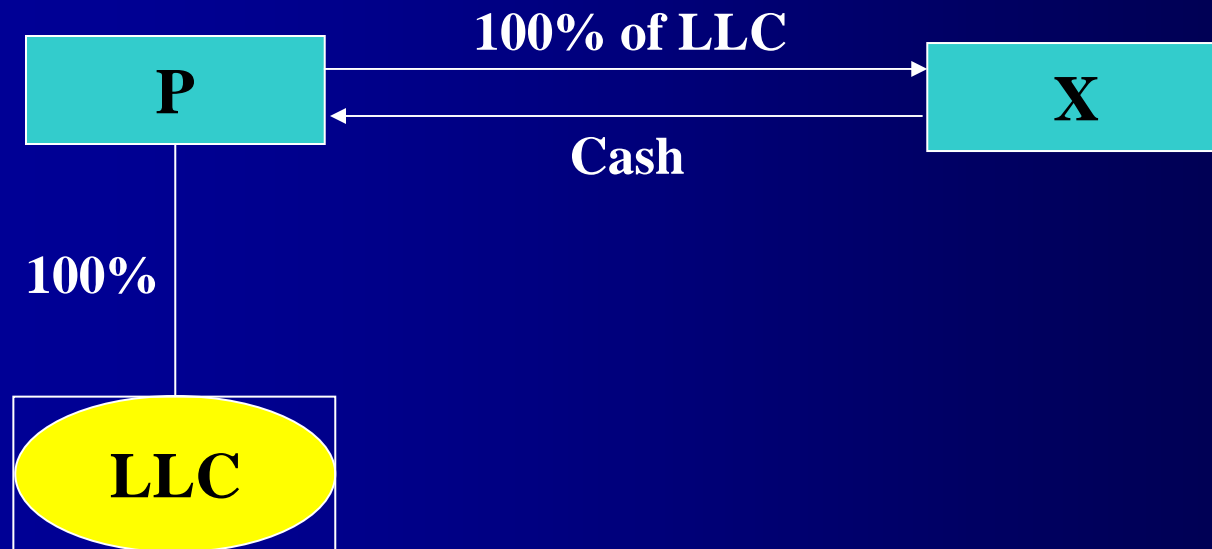


Note that S is not a member of the P-Q consolidated group because of the intervening ownership of PQ.

If S pays a dividend to PQ, what is the percentage that P and Q can exclude under section 243? Certainly not 100%; presumably 80%. See section 243(c)(2).

Sale of an Interest in a Disregarded Entity

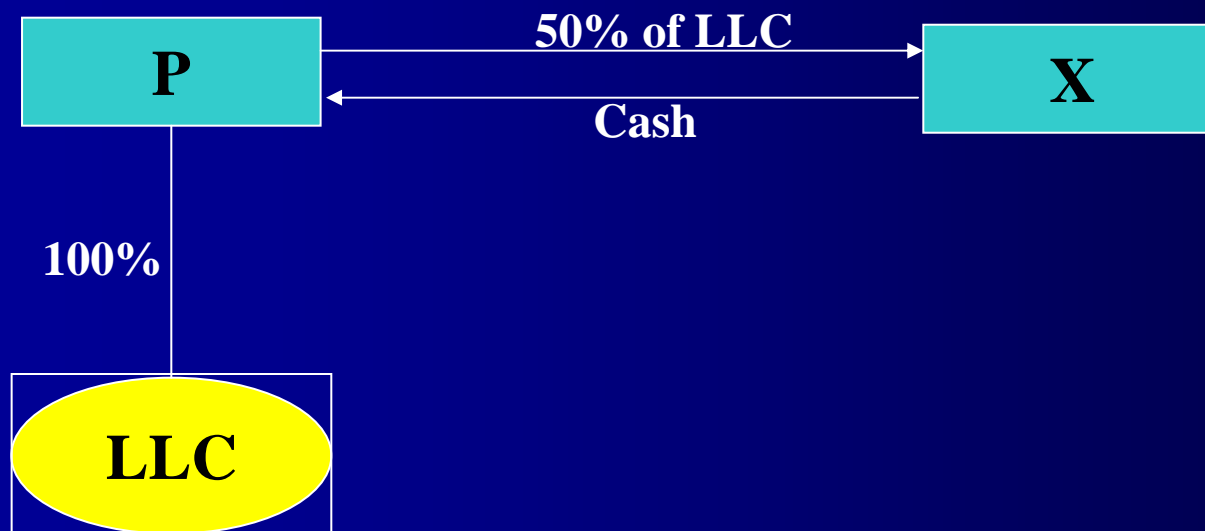
Sale of All of the Membership Interests



Facts: P owns all of the outstanding interests in LLC, which is treated as a disregarded entity for tax purposes. P sells all of the outstanding membership interests in LLC to X, an unrelated party.

Results: Because P is treated as owning all of the assets of LLC rather than LLC interests, P is treated as selling all of the assets of LLC to X.

Sale of Less than All of the Membership Interests

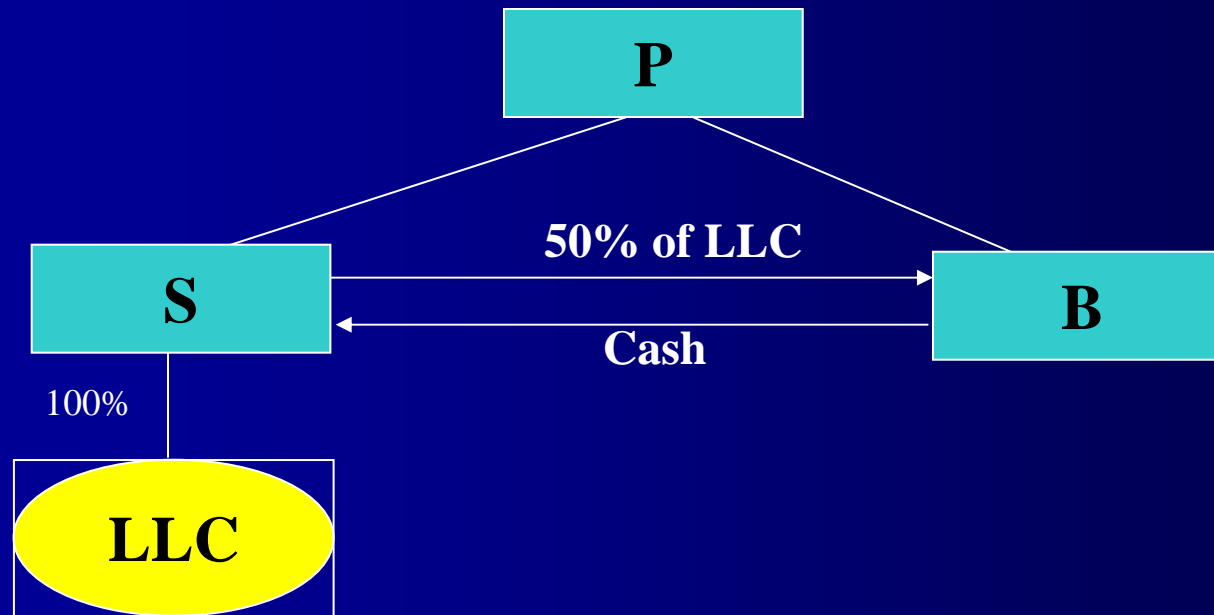


Facts: P owns all of the outstanding interests in LLC, which is treated as a disregarded entity for tax purposes. P sells 50% of the outstanding membership interests in LLC to X, an unrelated party.

Results: P is treated as having sold 50% of LLC's assets to X, followed by a contribution by X of the purchased assets and by P of the retained assets to a newly formed partnership. Rev. Rul. 99-5 (Sit. 1).

What are the results if, instead of P's selling the interests to X, X contributes cash to LLC in exchange for interests? See Rev. Rul. 99-5 (Sit. 2). What if the contributed cash is distributed to P within 2 years? See section 707(a)(2)(B). What if P sells 50% of the LLC's interests in a public offering? See section 7704.

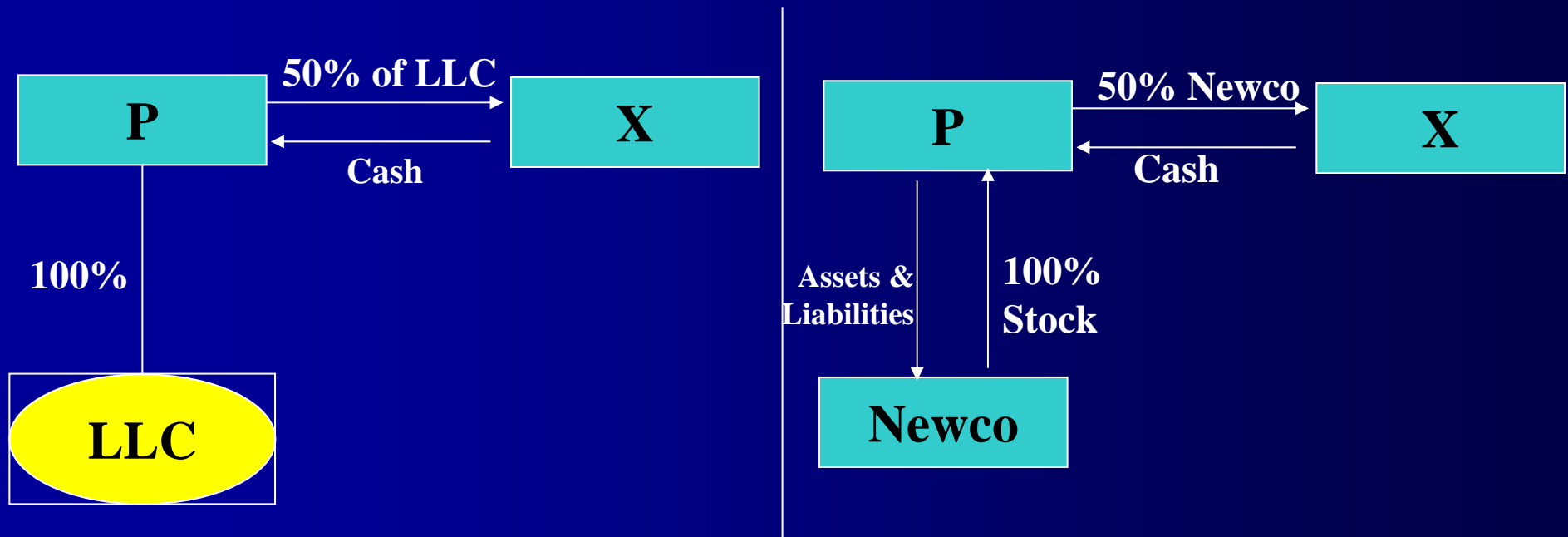
Sale of Less than All of the Membership Interests



Facts: S and B are members of a consolidated group. S owns all of the outstanding interests in LLC, which is treated as a disregarded entity for tax purposes. S sells 50% of the outstanding membership interests in LLC to B.

Results: S is treated as having sold 50% of LLC's assets to B in an intercompany sale, followed by a contribution by B of the purchased assets and by S of the retained assets to a newly formed partnership. Rev. Rul. 99-5 (Sit. 1). Thus, gain on the sale from S to B is triggered under Treas. Reg. § 1.1502-13(d) upon the contribution of assets to LLC. A better result is obtained if B contributes cash directly to LLC, so that there is no sale between S and B. However, if that cash is distributed to S within 2 years, S may be treated as selling 50% of LLC's assets to LLC in exchange for that cash under section 707(a)(2)(B). AN

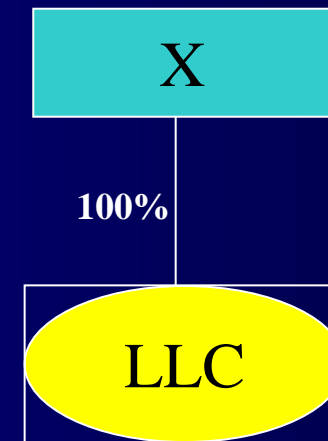
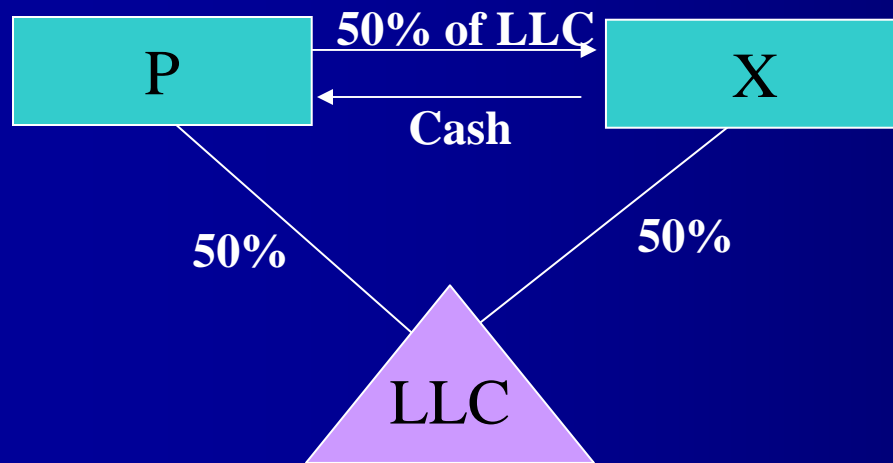
Overlap Between Automatic and Elective Changes In Classification



Facts: P owns all of the outstanding interests in LLC, which is treated as a disregarded entity for tax purposes. On January 1, 1998, P sells 50% of the outstanding membership interests in LLC to X, an unrelated party. P and X elect to treat the entity as an association effective January 1, 1998.

Results: The elective classification changes preempt the automatic classification change resulting from the change in the number of owners. Thus, P is treated as contributing all of the assets and liabilities of LLC to Newco and selling 50% of the Newco stock to X. See *Treas. Reg. § 301.7701-3(f)(2), (4) ex. 1.*

Sale of Membership Interests to Other Member

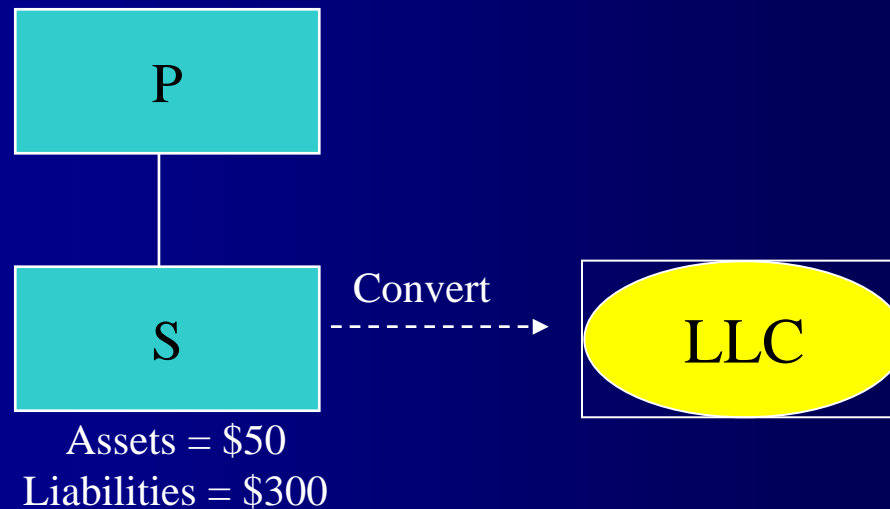


Facts: P and X each own a 50% interest in LLC. P sells its 50% LLC interest to X. After the sale, X is the sole owner of LLC, which is disregarded as an entity separate from X.

Results: The partnership terminates under section 708(b)(1)(A) when X purchases P's interest. P treats the transaction as a sale of a partnership interest. However, for purposes of determining the consequences to X, LLC is deemed to make a liquidating distribution of all of its assets to P and X, and X is treated as acquiring the assets distributed to P. *See Rev. Rul. 99-6. What if P and X are members of a consolidated group? See PLR 200334037.*

Insolvency and Bankruptcy Issues

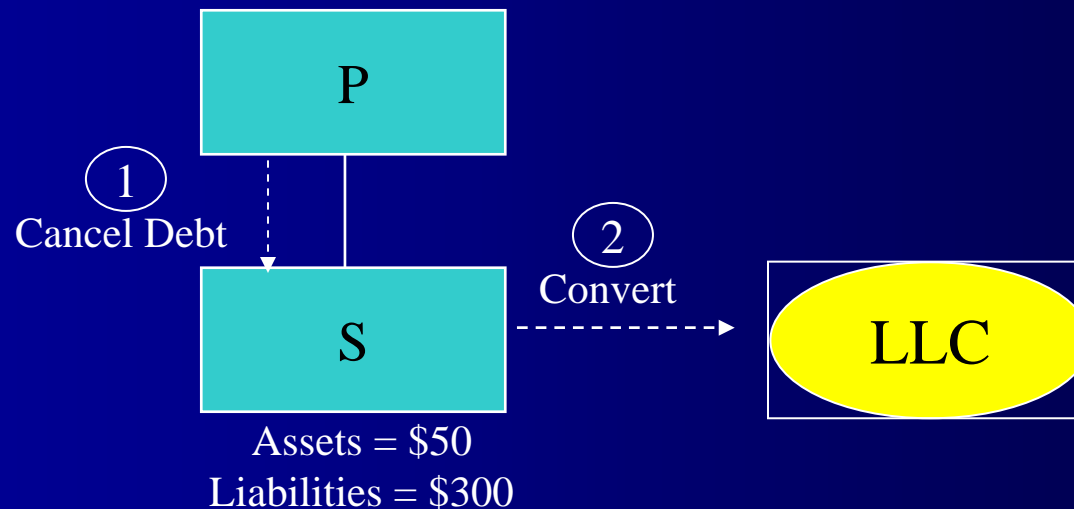
Consequences of Check-the-Box Election Election to be a Disregarded Entity



Facts: In year 1, P formed S and capitalized it with \$100 of equity and \$300 of debt. S loses \$350, rendering it insolvent. In year 2, S converts into an LLC under applicable state law.

Result: The conversion does not qualify as a tax-free section 332 liquidation. Instead, P is entitled to a worthless stock deduction under section 165(g)(3). *See* Treas. Reg. § 301.7701-3(g)(1)(iii), (g)(2)(ii); Rev. Rul. 2003-125; *see also* Prop. Treas. Reg. § 1.332-2(b).

Consequences of Check-the-Box Election Election to be a Disregarded Entity

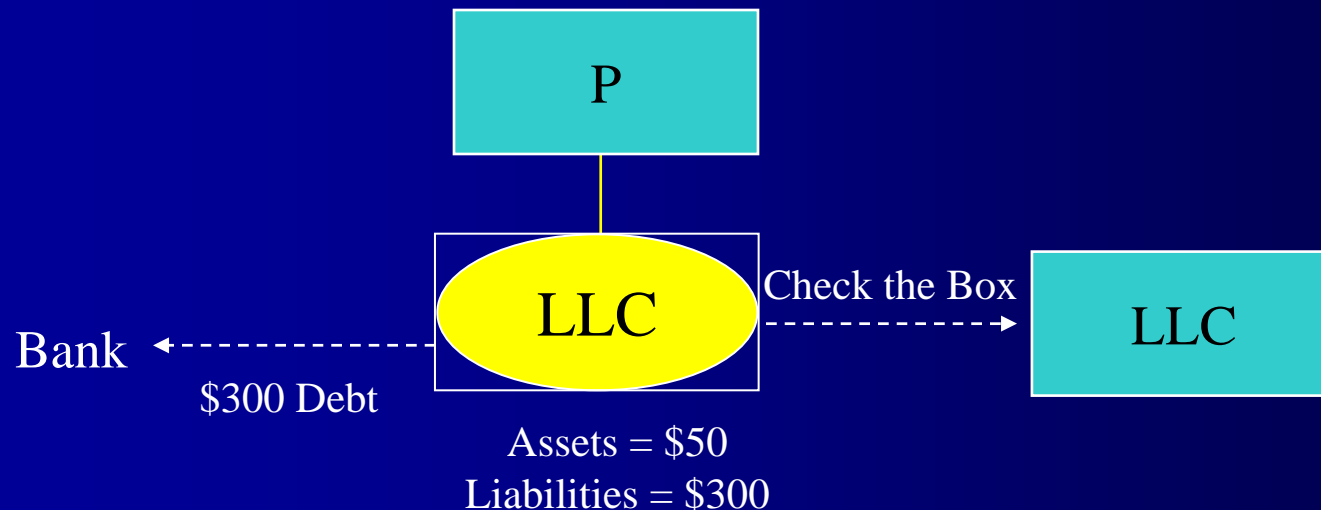


Facts: In year 1, P formed S and capitalized it with \$100 of equity and \$300 of debt. S loses \$350, rendering it insolvent. In year 2, P cancels the S debt and then S converts into an LLC under applicable state law.

Result: The debt cancellation is transitory and has no economic significance. Thus, S is insolvent at the time of the conversion and it does not qualify as a tax-free section 332 liquidation. *See Rev. Rul. 68-602.*

Variation: Buyer wants to purchase the assets of S, and Buyer and P agree that P will convert S into an LLC and sell Buyer the LLC interests. As a condition to the sale, however, LZ Buyer requests that P cancel the debt owed it by S. *See CCA 200818005.*

Consequences of Check-the-Box Election Election to be Taxed as a Corporation

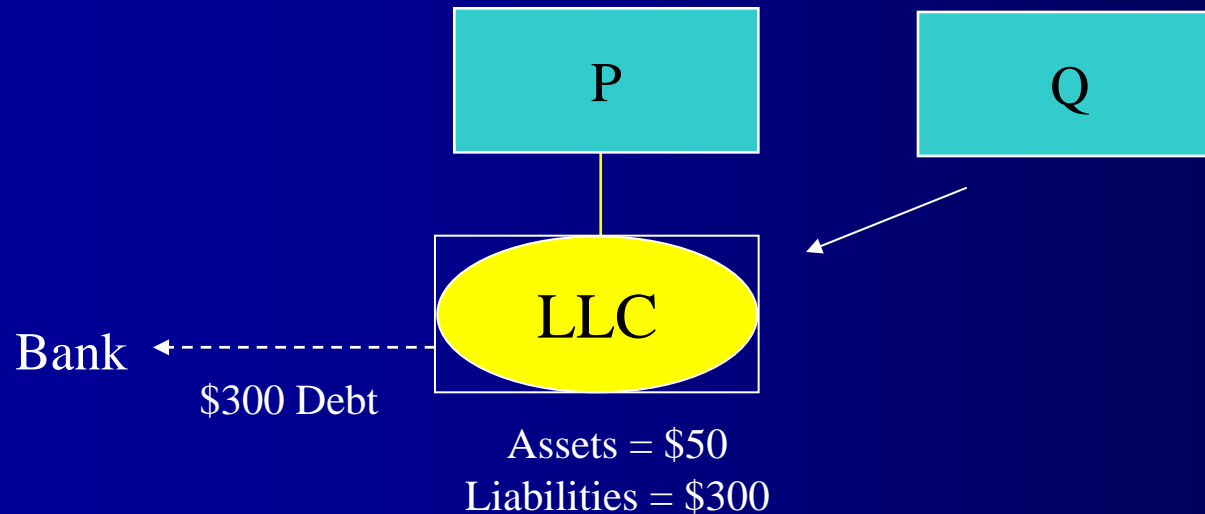


Facts: In year 1, P formed LLC and capitalized it with \$100 of equity. LLC borrowed \$300 from Bank. LLC loses \$350, rendering it insolvent. In year 2, LLC checks the box to be taxed as a corporation.

Result: P is treated as contributing all of LLC's assets and liabilities to a newly formed corporation in a transaction that may not qualify under section 351. See Treas. Reg. § 301.7701-3(g)(1)(iv), (g)(2)(ii). Compare *Rosen v. Commissioner*, 62 T.C. 11 (1974), *Focht v. Commissioner*, 68 T.C. 223 (1977), and GCM 33,915 (Aug. 26, 1968) with *DeFelice v. Commissioner*, 386 F.2d 704 (10th Cir. 1967); *Meyer v. United States*, 121 F. Supp. 898 (Ct. Cl. 1954); Prop. Treas. Reg. § 1.351-1(a)(1)(iii).

Consequences of Check-the-Box Election

Partnership Analog



Facts: In year 1, P formed LLC and capitalized it with \$100 of equity. LLC borrowed \$300 from Bank. LLC loses \$350, rendering it insolvent. In year 2, Q contributes \$250 in exchange for an interest in LLC.

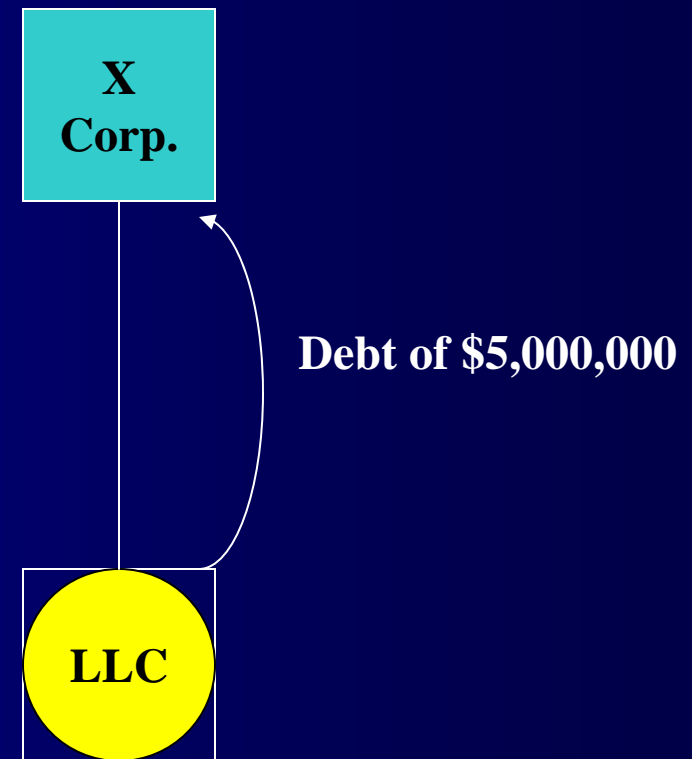
Result: P is treated as transferring all of LLC's assets and liabilities to a newly formed partnership in exchange for an interest in LLC. *See* Rev. Rul. 99-5 (Sit. 2). Query whether such an exchange should be tax-free to P pursuant to section 721. *Compare* section 351(a) *with* section 721(a); *see also* section 752(c); *cf.* Prop. Treas. Reg. § 1.351-1(a)(1)(iii).

Modification of Debt

Debt to Owner

LLC, taxable as a corporation and consolidated with X Corp., borrows \$5,000,000 from its owner, X, on a recourse basis. Sometime thereafter, LLC elects to be taxed as a disregarded entity. The change in classification is treated as a liquidation. How does the change in classification affect the debt?
See Kniffen v. Comm'r, 39 T.C. 553 (1962); Rev. Rul. 72-464; PLR 200814026.

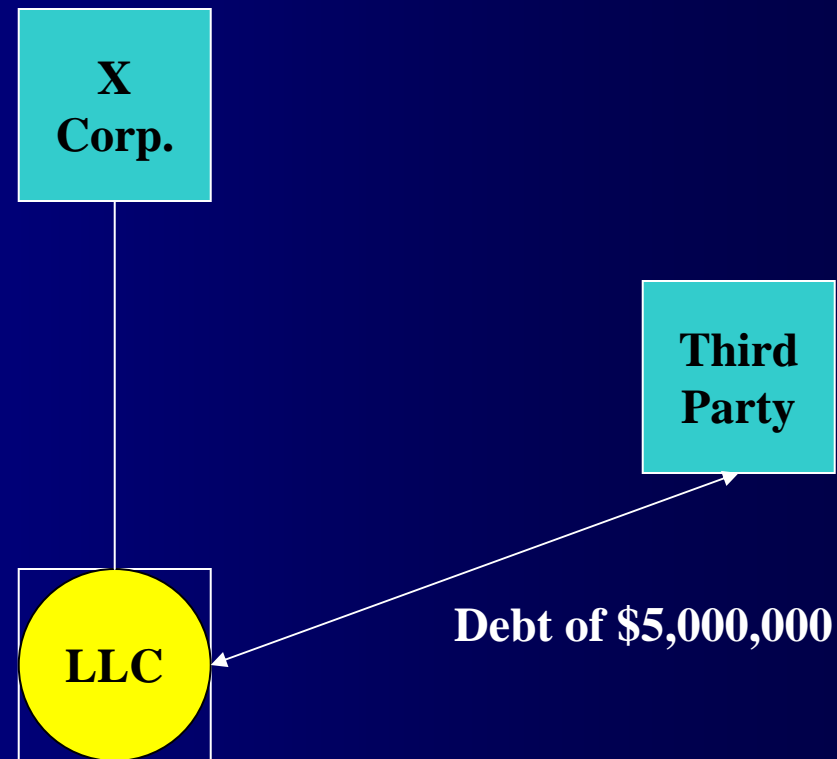
What if the facts are reversed, and LLC is disregarded when it borrows from X and then elects to be taxed as a corporation?



Modification of Debt

Third-Party Debt – Entity Conversion

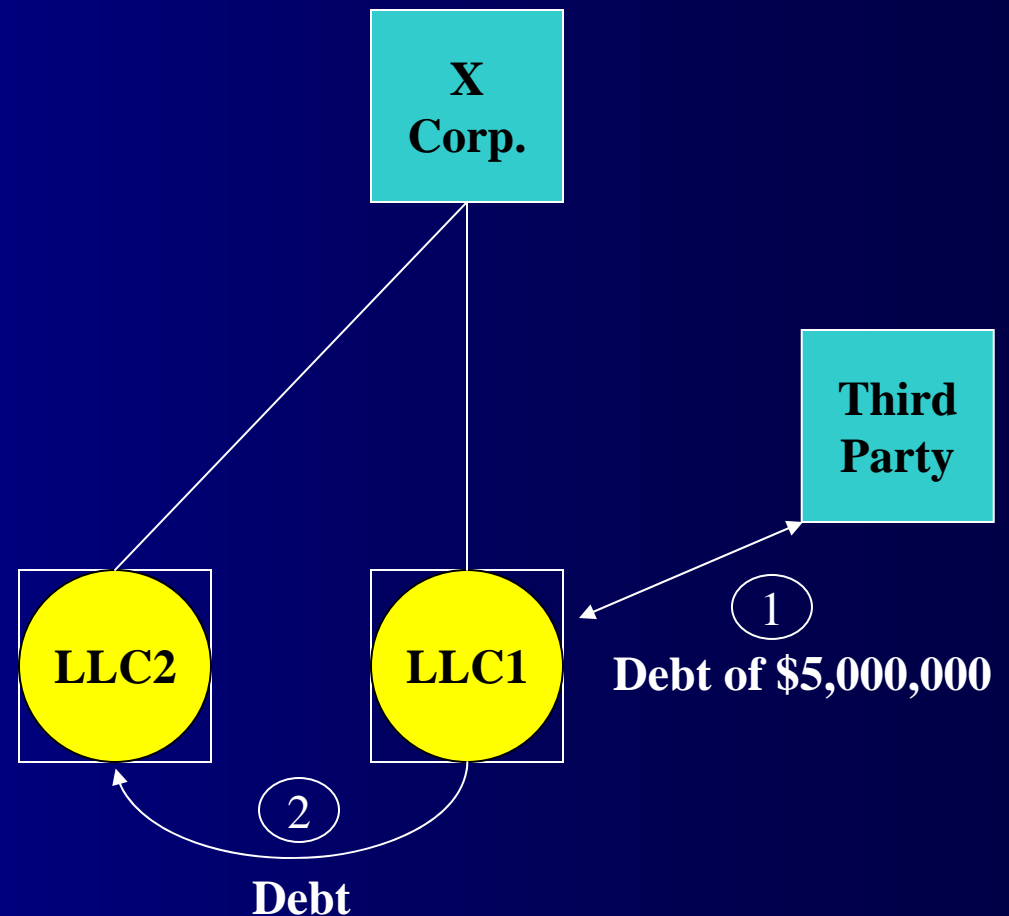
LLC, taxable as a corporation and consolidated with X Corp., borrows \$5,000,000 from a third party on a recourse basis. Sometime thereafter, LLC elects to be taxed as a disregarded entity. The change in classification is treated as a liquidation. How does the change in classification affect the debt? *See* Treas. Reg. §§ 1.465-27(b)(6), 1.752-2(k); *cf.* PLRs 200709013; 200630002; 200315001; 199904017.



Modification of Debt

Third-Party Debt – Change in Obligor

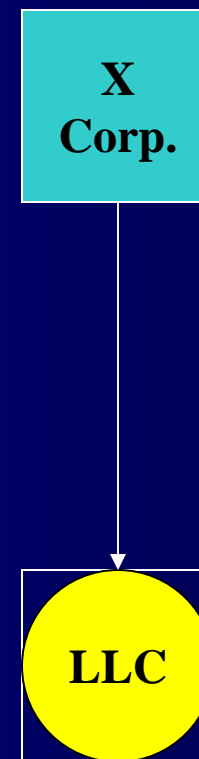
LLC1, a disregarded entity, borrows \$5,000,000 from a third party on a recourse basis. For valid business reasons, X would like to transfer the debt to LLC2. Does the transfer give rise to a significant modification of the debt?



Bankruptcy of Disregarded LLC

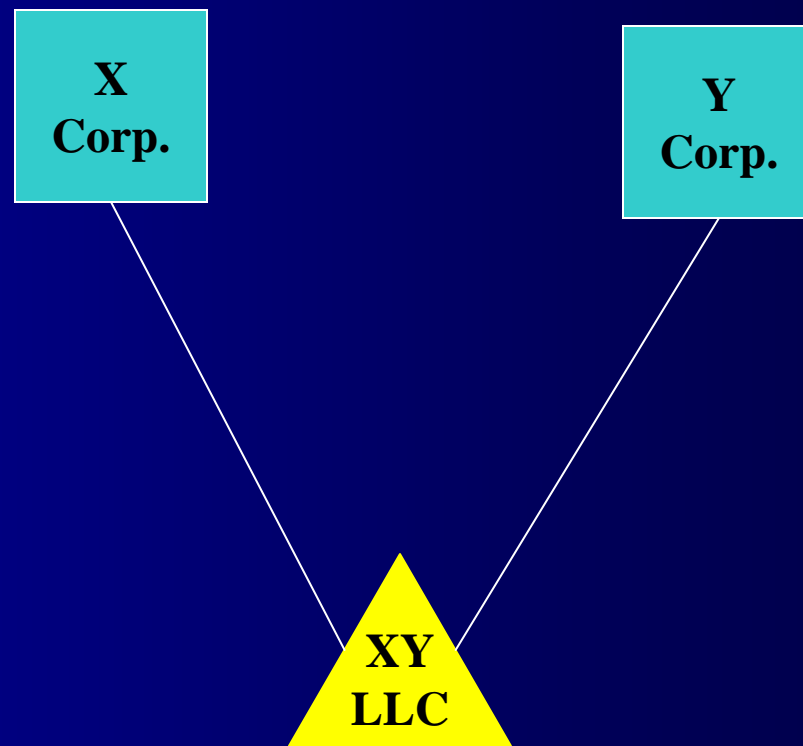
X Corp. forms LLC by contributing cash of \$5,000,000 and LLC borrows \$8,000,000 more. The business washes out, with LLC losing everything. LLC files for bankruptcy, triggering \$8,000,000 of COD *ordinary* income. Does section 108(a)(1)(A) apply? See sections 108(d)(2), 7701(a)(1), (14).

If section 108(a)(1)(A) applies, what tax attributes are reduced? See section 108(b)(1), (2).

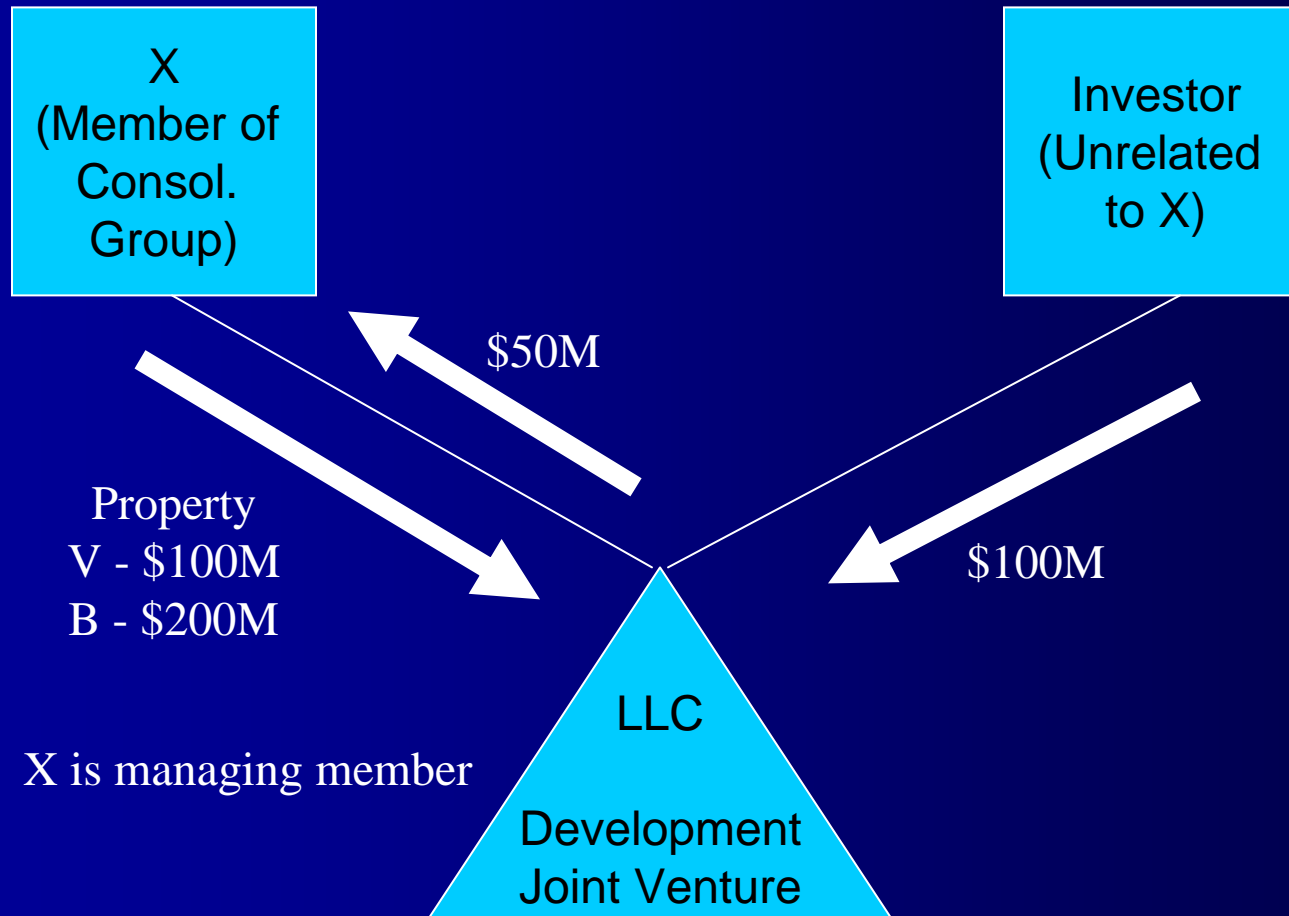


Bankruptcy of Regarded LLC

X and Y form XY LLC by contributing cash of \$5,000,000 and XY LLC borrows \$8,000,000 more. The business washes out, with XY LLC losing everything. XY LLC files for bankruptcy, triggering \$8,000,000 of COD *ordinary* income. How does section 108 apply? See section 108(d)(6).



Recognizing Tax Benefits from Economic Downturns -- Loss Recognition & Section 707(b)



What if X has a 50% capital interest and a 60% profits interest in LLC?

What if X has a 50% capital interest and profits interest in LLC?

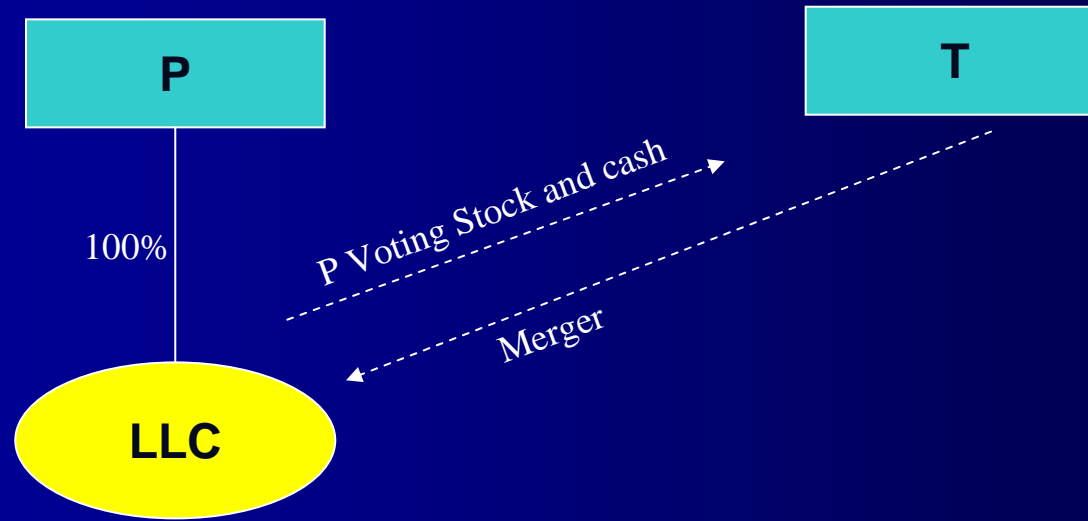
What if X has a 50% capital interest and profits interest in LLC, except for a contingent right to 51% of certain profits?

What if X has a right to reacquire the Property for FMV after a period of 2 years?

Reorganizations Involving Disregarded Entities

Final Section 368 Regulations

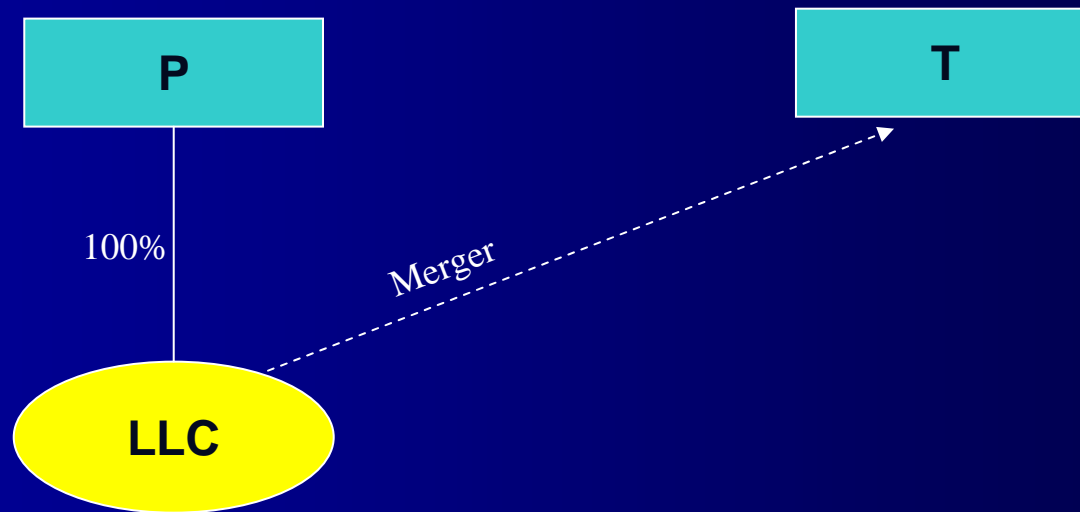
Merger of Target into Disregarded Entity



Facts: P and T are domestic corporations and LLC is a domestic limited liability company. LLC is wholly owned by P. LLC is treated as a disregarded entity. P and T are combining entities. P and LLC comprise a combining unit, and T is a combining unit. T merges into LLC under state statutory merger law, with the T shareholders receiving consideration of 50% P voting stock and 50% cash.

Final Section 368 Regulations

Merger of Disregarded Entity into Corporation



Facts: P and T are domestic corporations and LLC is a domestic limited liability company. LLC is wholly owned by P. LLC is treated as a disregarded entity. P and LLC comprise a combining unit, and T is a combining entity and combining unit. LLC merges into T under state statutory merger law with shareholders of T receiving P stock and cash.

Final Section 368 Regulations

Mergers and Consolidations

- On January 23, 2006, the IRS and Treasury issued final regulations defining the term “statutory merger or consolidation” as that term is used in the definition of an “A” reorganization under section 368(a)(1)(A) of the Code. These final regulations were the result of several iterations of proposed and temporary regulations and modifications made in response to comments.
 - The 2000 proposed regulations (May 16, 2000) provided that neither the merger of a disregarded entity into a corporation nor the merger of a target corporation into a disregarded entity could qualify as an A reorganization.
 - On November 15, 2001, the IRS and Treasury withdrew the 2000 proposed regulations and issued new proposed regulations that permitted certain statutory mergers involving disregarded entities to qualify as A reorganizations, if all of the assets and liabilities of the target are transferred to the acquiror and the target goes out of existence.
 - On January 24, 2003, the IRS and Treasury made certain minor clarifications to the proposed regulations and issued them as temporary regulations.
 - On January 5, 2005, the IRS and Treasury issued proposed regulations that would expand the temporary regulations to include mergers involving foreign entities and mergers effected pursuant to foreign laws within the scope of “statutory merger or consolidation.”

Final Section 368 Regulations

Definition of Terms

- A “statutory merger or consolidation” is defined as a transaction effected pursuant to the statute or statutes necessary to effect the merger or consolidation, in which transaction, as a result of the operation of such statute or statutes, the following events occur simultaneously at the effective time of the transaction in which:
 - All of the assets (other than those distributed in the transaction) and liabilities (except to the extent such liabilities are satisfied or discharged in the transaction or are nonrecourse liabilities to which assets distributed in the transaction are subject) of each member of one or more combining units (each a transferor unit) become the assets and liabilities of one or more members of one other combining unit (transferee unit), and
 - The combining entity of each transferor unit ceases its separate legal existence for all purposes.
 - This requirement will be satisfied even if, under applicable law, after the effective time of the transaction, the combining entity of the transferor unit (or its officers, directors, or agents) may act or be acted against, or a member of the transferee unit (or its officers, directors, or agents) may act or be acted against in the name of the combining entity of the transferor unit, provided that such actions relate to assets or obligations of the combining entity of the transferor unit that arose, or relate to activities engaged in by such entity, prior to the effective time of the transaction, and such actions are not inconsistent with the combination requirement above.
- The final regulations adopt the change in the proposed regulations to permit mergers or consolidations involving foreign entities and mergers or consolidations pursuant to foreign laws.

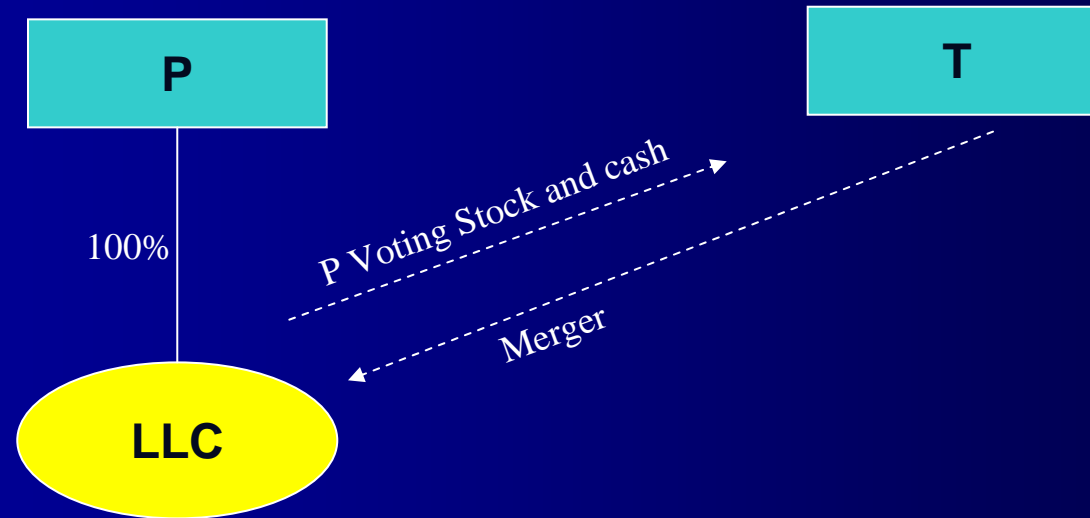
Final Section 368 Regulations

Definition of Terms

- The following terms are defined in the final regulations for purposes of defining statutory merger or consolidation:
 - Disregarded entity - Business entity (as defined in Treas. Reg. § 301.7701-2(a)) that is disregarded as an entity separate from its owner for federal income tax purposes. Examples include domestic single-member LLCs that do not elect to be treated as corporations, qualified REIT subsidiaries, and qualified subchapter S subsidiaries.
 - Combining entity - Business entity that is a corporation that is not a disregarded entity.
 - Combining unit - Comprised solely of a combining entity and all disregarded entities, if any, owned by the combining entity.

Final Section 368 Regulations

Merger of Target Into Disregarded Entity

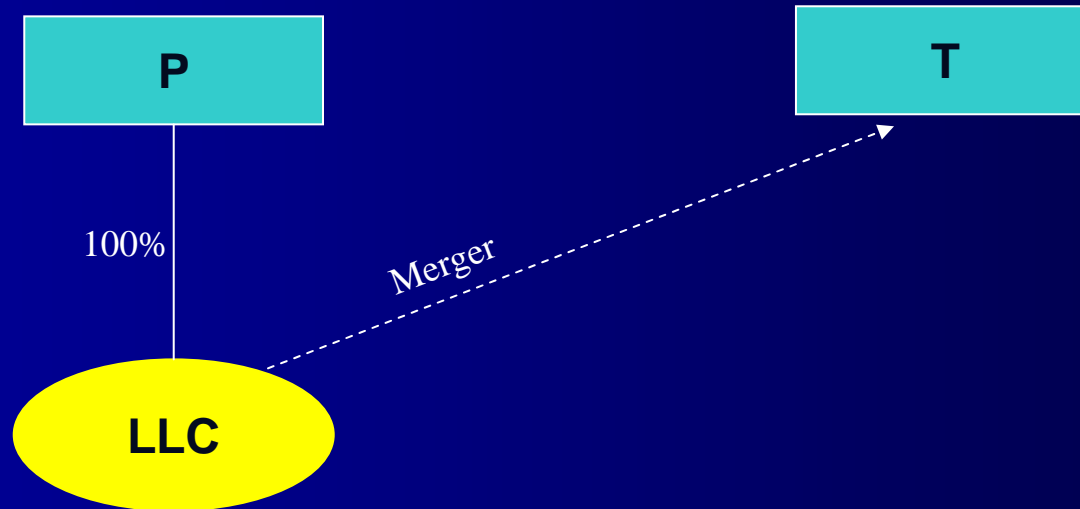


Facts: P and T are domestic corporations and LLC is a domestic limited liability company. LLC is wholly owned by P. LLC is treated as a disregarded entity. P and T are combining entities. P and LLC comprise a combining unit, and T is a combining unit. T merges into LLC under state statutory merger law, with the T shareholders receiving consideration of 50% P voting stock and 50% cash.

Result: The transaction qualifies as a tax-free A reorganization under Treas. Reg. § 1.368-2(b)(1)(ii).
See Treas. Reg. § 1.368-2(b)(1)(iii), ex. 2.

Final Section 368 Regulations

Merger of Disregarded Entity Into Corporation



Facts: P and T are domestic corporations and LLC is a domestic limited liability company. LLC is wholly owned by P. LLC is treated as a disregarded entity. P and LLC comprise a combining unit, and T is a combining entity and combining unit. LLC merges into T under state statutory merger law with shareholders of T receiving P stock and cash.

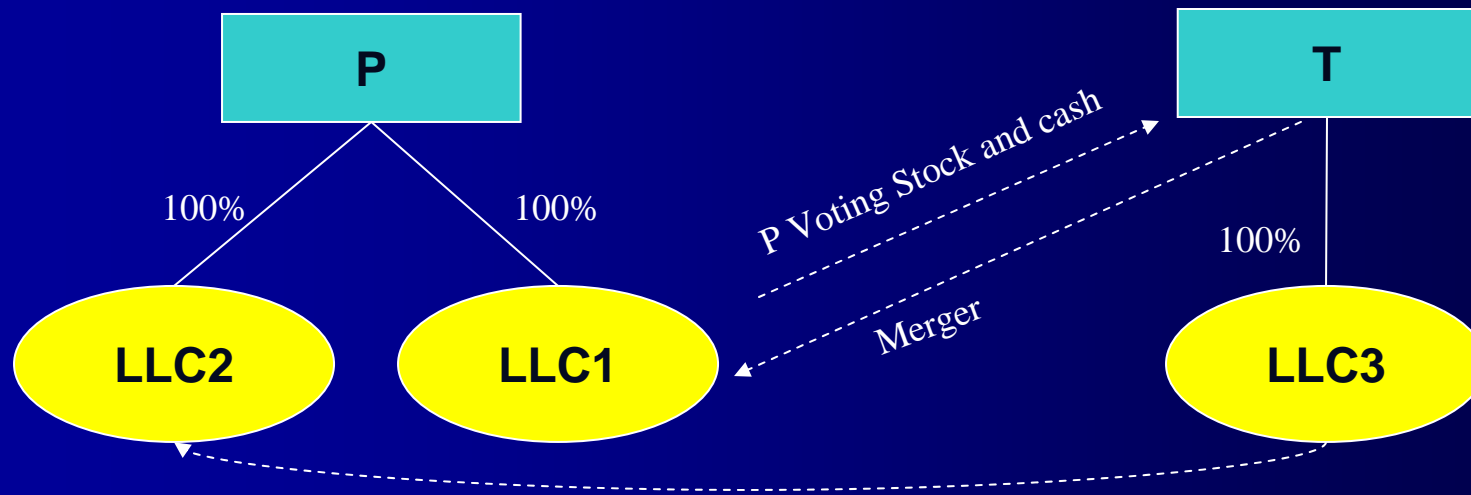
Result: The transaction does not qualify as a tax-free A reorganization under Treas. Reg. § 1.368-2(b)(1)(ii) because all of assets and liabilities of the combining unit of P and LLC do not become assets of T, and LLC is not a combining entity. See Treas. Reg. § 1.368-2(b)(1)(iii), ex. 6.

Notes: If LLC is a transitory merger subsidiary, is a recast under Rev. Rul. 67-448 available if only P shares are used?

If LLC is not a transitory merger subsidiary, could the transaction be viewed as a section 351 transaction to the extent of the LLC assets (and possibly a “B” reorganization with respect to the rest)?

Final Section 368 Regulations

Merger of Target and LLC Into Separate DE's

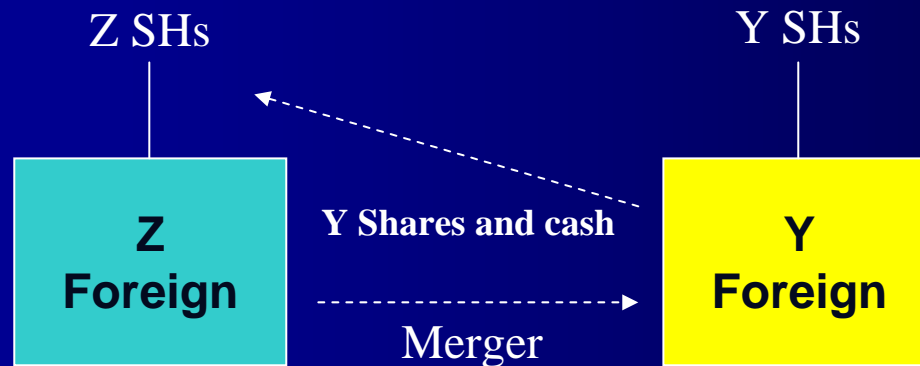


Facts: P and T are domestic corporations and LLC₁, LLC₂, and LLC₃ are domestic limited liability companies. LLC₁ and LLC₂ are wholly owned by P. LLC₃ is wholly owned by T. The LLCs are treated as disregarded entities. P, LLC₁, and LLC₂ comprise a combining unit, and T and LLC₃ comprise a combining unit. T merges into LLC₁ under state statutory merger law, with the T shareholders receiving consideration consisting of 50% P voting stock and 50% cash. LLC₃ merges into LLC₂ under state statutory merger law.

Result: The transaction qualifies as a tax-free A reorganization under Treas. Reg. § 1.368-2(b)(1)(ii). See Treas. Reg. § 1.368-2(b)(1)(iii), ex. 2.

Final Section 368 Regulations

Merger of Foreign Entities Under Foreign Law

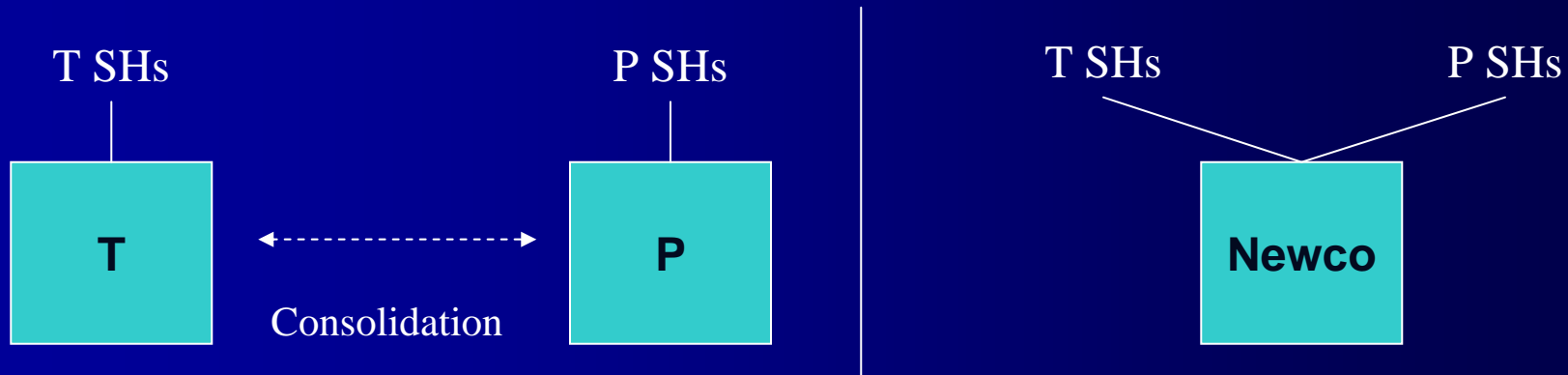


Facts: Z and Y are entities organized under the laws of Country Q and classified as corporations for Federal tax purposes. Z merges into Y under Country Q law. Pursuant to statutes of Country Q the following events occur simultaneously: (i) all of the assets and liabilities of Z become the assets and liabilities of Y, (ii) Z's separate legal existence ceases for all purposes, and (iii) Z shareholders receive consideration consisting of 50% Y voting stock and 50% cash.

Result: Under the final regulations, this transaction qualifies as an "A" reorganization. See Treas. Reg. § 1.368-2(b)(1)(ii), -2(b)(1)(iii) Ex. 13.

Final Section 368 Regulations

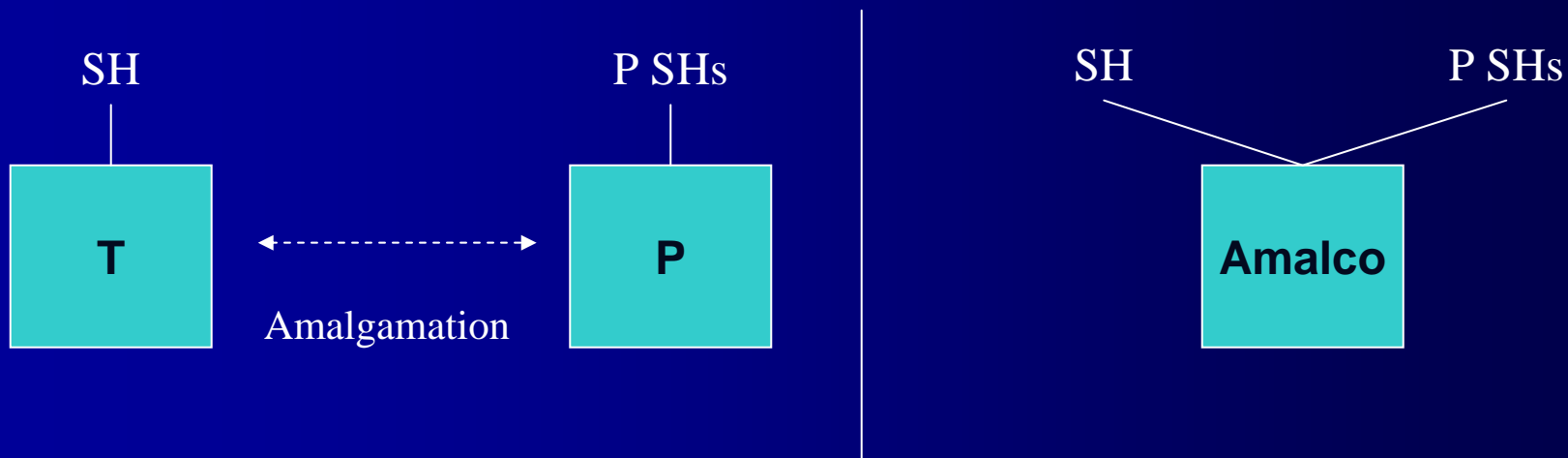
State Law Consolidation



Facts: Under state W law, T and P consolidate. Pursuant to such law, the following events occur at the effective time of the transaction: all of the assets and liabilities of T and P become the assets and liabilities of Newco, an entity that is created in the transaction, and the existence of T and P continues in Newco. In the consolidation, the T and P shareholders exchange their stock of T and P, respectively, for stock of Newco.

Result: Under the final regulations, the consolidation qualifies as an “A” reorganization, because it is a transaction effected pursuant to the statute or statutes necessary to effect the merger or consolidation (i.e., State W consolidation law), all of the assets and liabilities of each member of one or more combining units (i.e., P and T) become the assets and liabilities of one or more members of another combining unit (i.e., Newco). *See* Treas. Reg. § 1.368-2(b)(1)(ii). The fact that the existence of the consolidating corporations (T and P) continues in Newco under State W law will not prevent the consolidation from qualifying as a statutory merger or consolidation. *See* Preamble to Treas. Reg. § 1.368-2(b); Treas. Reg. § 1.368-2(b)(1)(iii), Ex. 12.

Final Section 368 Regulations Amalgamation Under Foreign Law

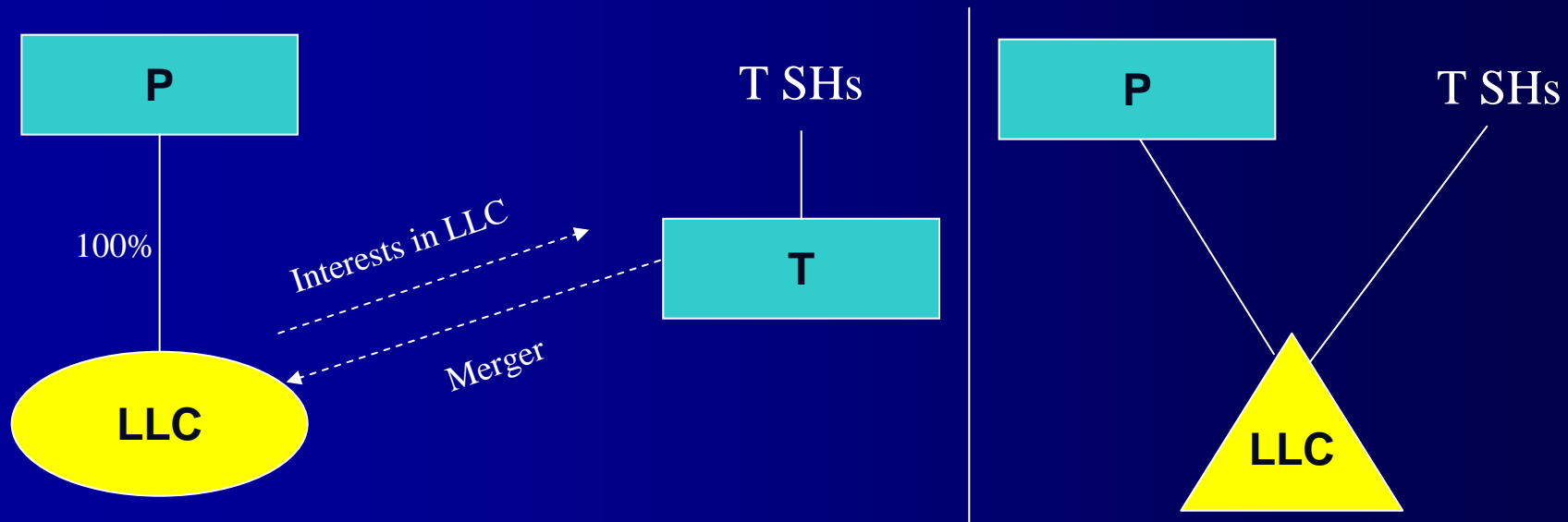


Facts: T, a Country Q Limited Company with a single US shareholder (SH), amalgamates with P, also a Country Q Limited Company, pursuant to the law of Country Q. By operation of law, the assets of T and P become assets of a new entity (“Amalco”), P and T cease their separate existence, and SH and the P shareholders receive shares of Amalco stock as consideration. SH receives 30% of Amalco’s outstanding shares.

Result: Under the final regulations, the amalgamation qualifies as an “A” reorganization, because it is a transaction effected pursuant to the statute or statutes necessary to effect the merger or consolidation (i.e., Country Q amalgamation law), all of the assets and liabilities of each member of one or more combining units (i.e., P and T) become the assets and liabilities of one or more members of another combining unit (i.e., Amalco). *See* Treas. Reg. § 1.368-2(b). The fact that the existence of the amalgamating corporations (T and P) continues in Amalco under Country Q law will not prevent the amalgamation from qualifying under the final regulations as a statutory merger or consolidation. *See* Preamble to Treas. Reg. § 1.368-2(b); Treas. Reg. § 1.368-2(b)(1)(iii), Ex. 14.

Final Section 368 Regulations

Merger of Corporation Into DE in Exchange for DE Interests



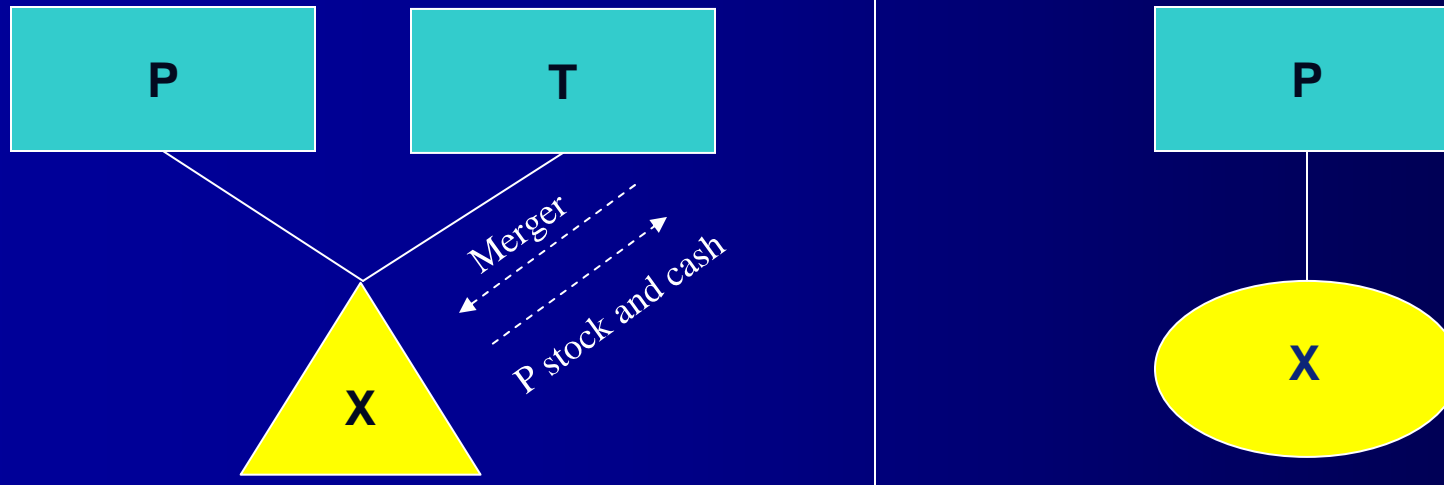
Facts: P and T are domestic corporations and LLC is a domestic limited liability company. LLC is wholly owned by P. LLC is treated as a disregarded entity. T merges into LLC under state statutory merger law, with the T shareholders receiving interests in LLC. After merger, LLC is not disregarded as an entity separate from P and is treated as a partnership for federal income tax purposes.

Result: The transaction does not qualify as a tax-free A reorganization because assets of T do not become assets of a combining unit. LLC cannot be a combining entity as a partnership and, thus, is not part of a combining unit. See Treas. Reg. § 1.368-2(b)(1)(iii), ex. 7.

Note: What if LLC elects to be taxed as a corporation effective at the time of the merger? See Rev. Rul. 76-123; Rev. Rul. 68-349; Rev. Rul. 68-357.

Final Section 368 Regulations

Merger of Corporate Partner Into Partnership

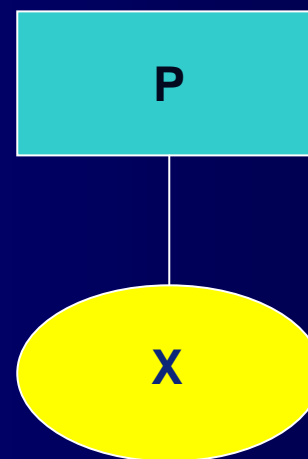
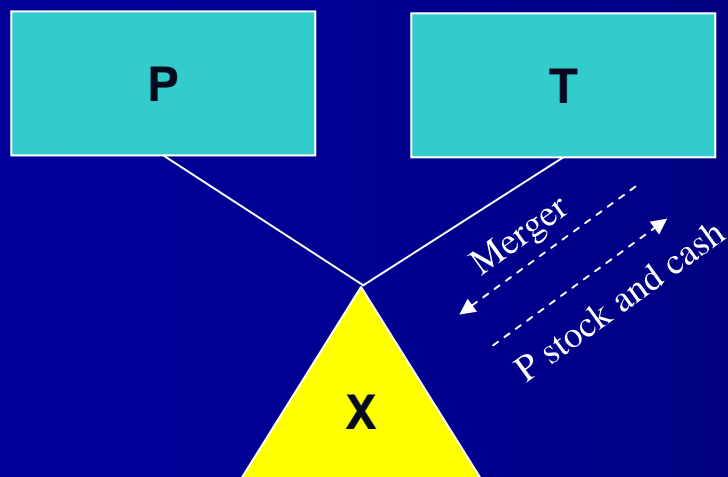


Facts: P and T, both corporations, together own all of the membership interests in X, a limited liability company that is treated as a partnership for federal income tax purposes. Under State W law, T merges into X. Pursuant to such law, the following events occur simultaneously at the time of the transaction: all of the assets and liabilities of T become the assets and liabilities of X, and T ceases its separate legal existence for all purposes. In the merger, the shareholders of T exchange their T stock for consideration consisting of 50% P stock and 50% cash. As a result of the merger, X becomes an entity that is disregarded as an entity separate from P.

Result: Under the final regulations, the transaction satisfies the requirements of a statutory merger or consolidation because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of T, the combining entity and sole member of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of P, the combining entity of the transferee unit, and X, a disregarded entity the assets of which P is treated as owning for tax purposes immediately after the transaction, and T ceases its separate legal existence for all purposes. *See* Treas. Reg. § 1.368-2(b)(1)(iii), ex. 11. The existence and composition of the transferee unit are determined immediately after (but not immediately before) the merger. *See* Preamble to Treas. Reg. § 1.368-2(b)(1).

Final Section 368 Regulations

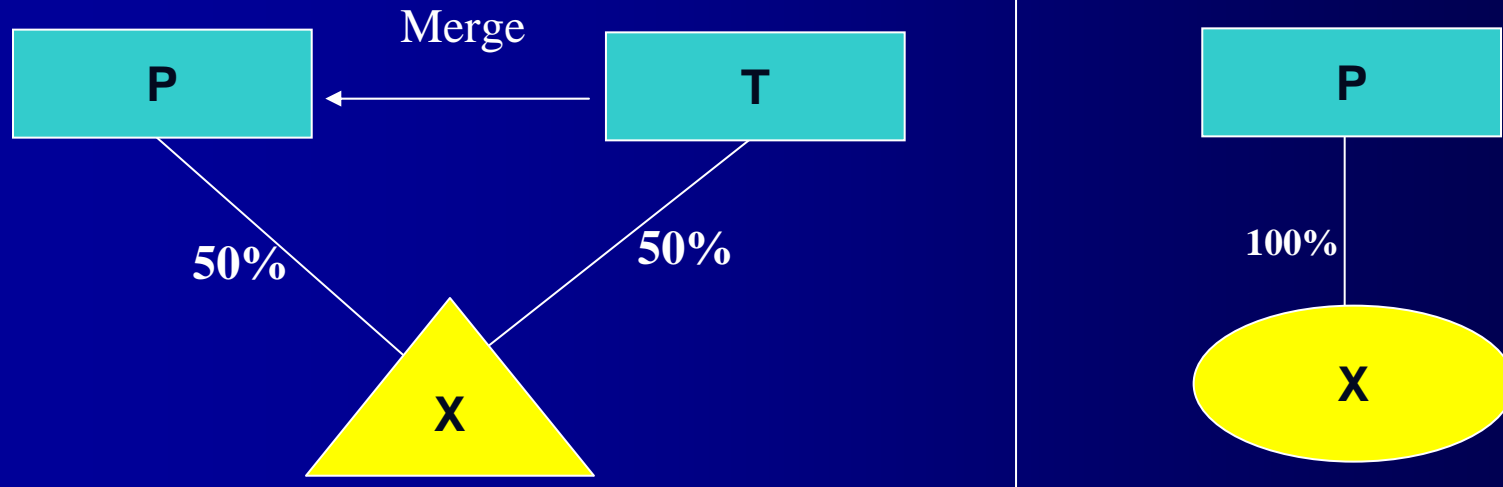
Merger of Corporate Partner Into Partnership (Cont.)



Issues: In this transaction, X terminates as a partnership under section 708(b)(1)(A). The preamble to Treas. Reg. § 1.368-2(b)(1) notes that this transaction “raises questions as to the tax consequences of the transaction to the parties, including whether gain or loss may be recognized under the partnership rules...as a result of the termination of” X. The preamble also inquires whether the principles of Rev. Rul. 99-6 should apply to this transaction.

Final Section 368 Regulations

Merger of Corporate Partner Into Other Partner

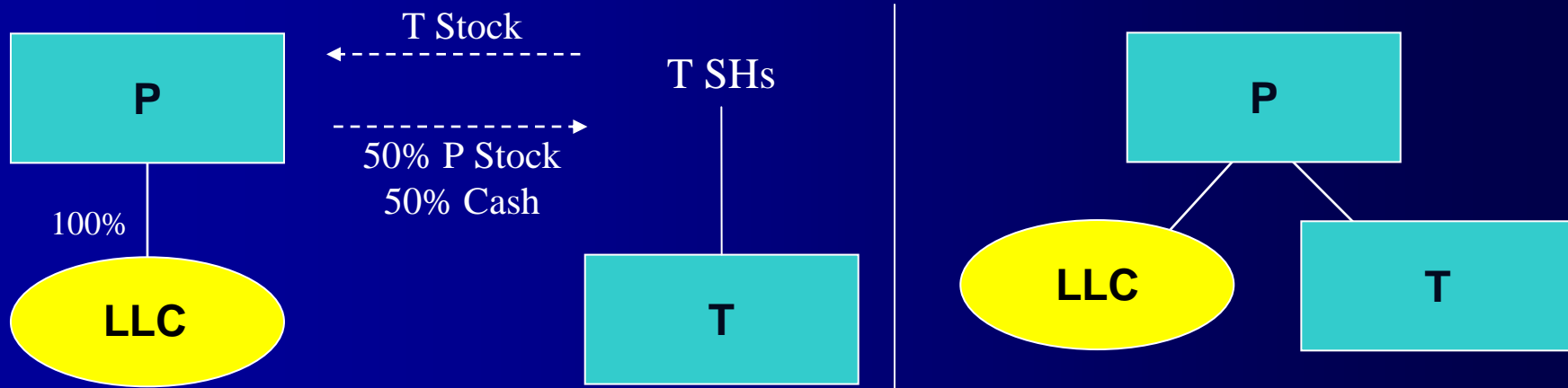


Facts: P and T each own a 50% interest in X. T merges into P in an “A” reorganization. Afterward, P is the sole owner of X, which is disregarded as an entity separate from P.

Results: The partnership terminates under section 708(b)(1)(A) when P acquires T’s interest in X by operation of law. Does Rev. Rul. 99-6 apply to this type of partnership termination? Rev. Rul. 99-6 involved a taxable sale of a partnership interest from T to P. All the authorities cited in Rev. Rul. 99-6 involve taxable sales of partnership interests. See Rev. Rul. 67-65; Rev. Rul. 55-68; *McCauslen v. Comm’r*, 45 T.C. 588. Nonetheless, Rev. Rul. 84-111 (Sit. 3) appears to apply *McCauslen* in the context of a tax-free section 351 transaction. Treasury and the IRS have requested comments on whether “the principles of Revenue Ruling 99-6” apply to these facts. T.D. 9242 (Jan. 23, 2006).

Final Section 368 Regulations

Step Transaction Issues



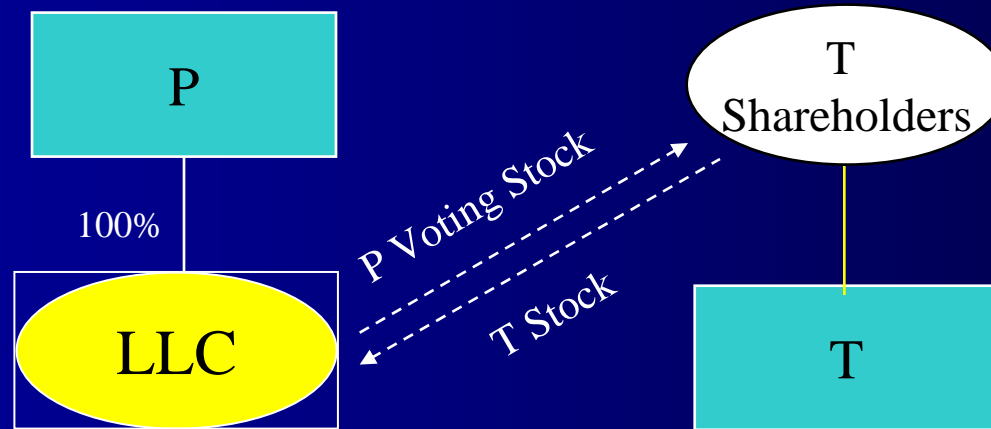
Facts: P and T are domestic corporations. P owns all of the interests in LLC, a domestic limited liability company that is disregarded for federal tax purposes. T's shareholders transfer their T stock to P in exchange for 50% P stock and 50% cash. Immediately after the acquisition, T engages in one of the following alternative transactions.

- (1) T merges into P = A reorganization
- (2) T merges into LLC = A reorganization
- (3) T files a form in Delaware to become an LLC = Not an A reorganization
- (4) T checks the box to be treated as a disregarded entity = Not an A reorganization
- (5) T liquidates into P = Not an A reorganization
- (6) T dissolves = Not an A reorganization if remaining property does not vest in parent upon dissolution

Does the form of the second step determine the characterization of the transaction? Under what circumstances could a state law liquidation be treated as a consolidation treated as an A reorganization?

See King Enterprises, Inc. v. United States, 418 F. 2d 511 (Ct. Cl. 1969); Rev. Rul. 67-274; Rev. Rul. 72-405; Rev. Rul. 2008-25; Rev. Rul. 2001-46; Rev. Rul. 90-95; PLR 9539018; Preamble to Treas. Reg. § 1.368-2(b)(1).

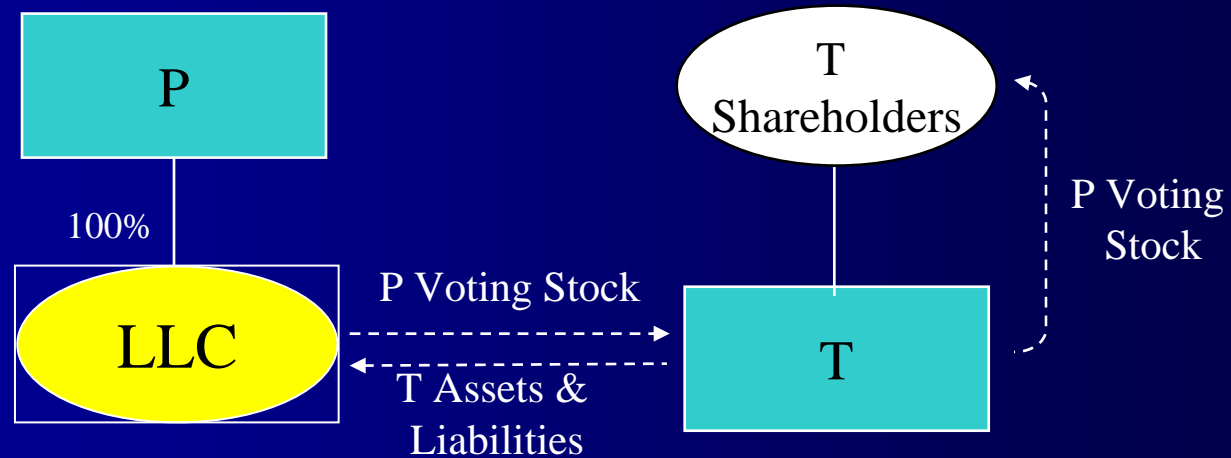
B Reorganization



Facts: P would like to acquire the stock of T in a tax-free reorganization. Accordingly, P forms a wholly owned LLC, which is treated as a disregarded entity. LLC acquires the T stock from T's shareholders in exchange for P voting stock.

Result: The transaction should qualify as a tax-free B reorganization.

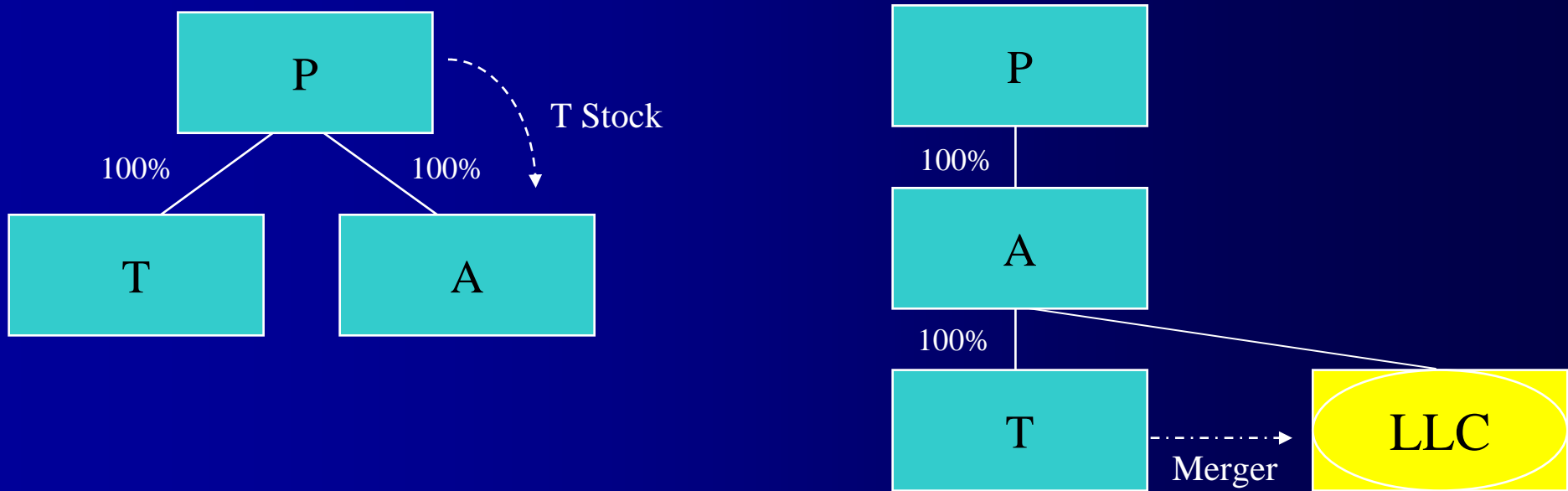
C Reorganization



Facts: P would like to acquire the assets and operating liabilities of T in a tax-free reorganization, but T has certain liabilities that P wants to leave behind. Accordingly, P forms a wholly owned LLC, which is treated as a disregarded entity. T transfers its assets and operating liabilities to LLC in exchange for P voting stock and distributes the P stock to its shareholders in complete liquidation (subject to satisfaction of any remaining liabilities).

Result: The transaction should qualify as a tax-free C reorganization, with P as the acquiring corporation. *See Rev. Rul. 70-107; cf. GCM 39,102.*

D Reorganization

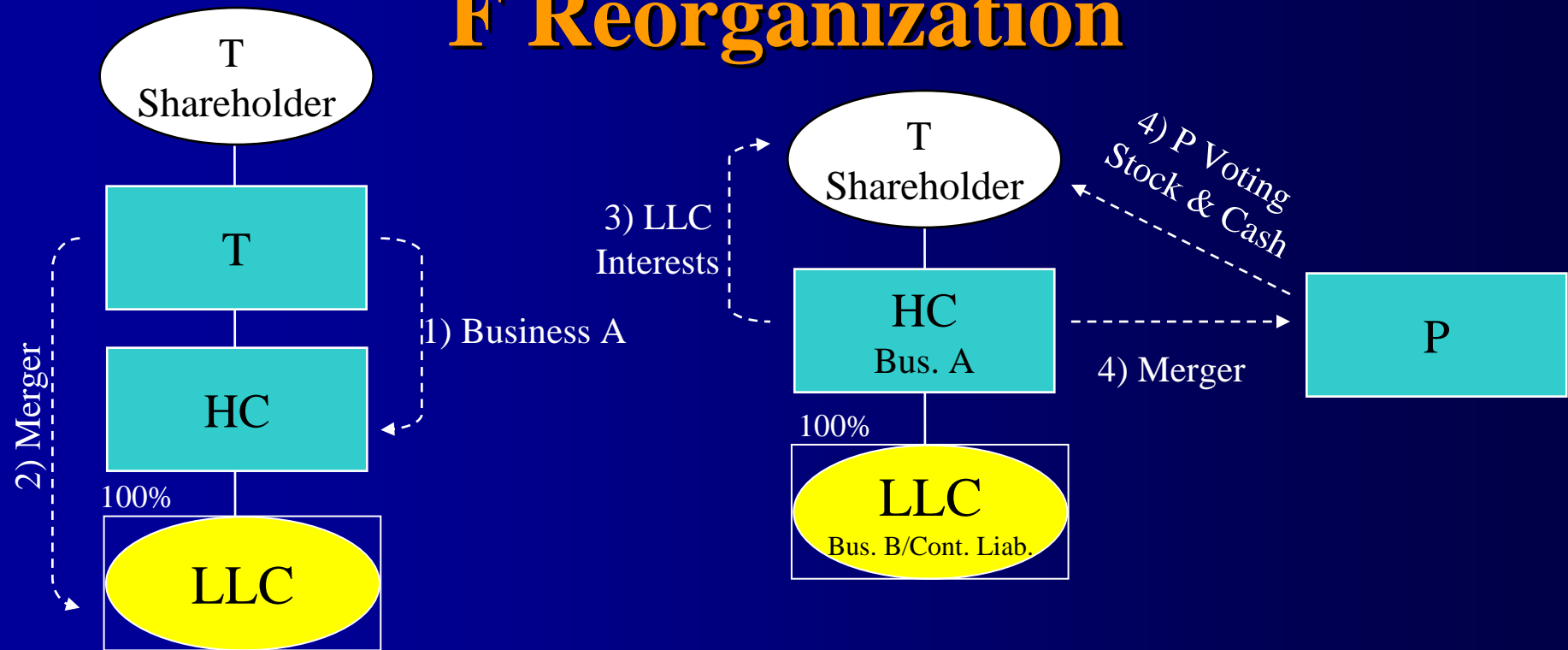


Facts: P owns all of the stock of two corporations, T and A. P contributes all of its T stock to A. Immediately thereafter, A forms a wholly owned LLC, and T merges into LLC.

Result: The contribution of T stock and the subsequent merger of T into LLC should be integrated and treated as if T transferred all of its assets directly to A in exchange for A stock and then distributed the A stock to P in complete liquidation. The transaction, as recharacterized, should qualify as a tax-free acquisitive D reorganization. *See* PLR 200445016; *see also* Rev. Rul. 2004-83 (taxable sale of subsidiary stock to another subsidiary followed by an actual liquidation treated as a D reorganization); PLR 200430025 (transfer of stock followed by a QSub election treated as a D reorganization).

Note that, as a result of the AJCA, section 357(c) no longer applies when T's liabilities exceed T's aggregate basis in its assets as long as the D reorganization is acquisitive. *See* section 357(c)(1)(B).

F Reorganization

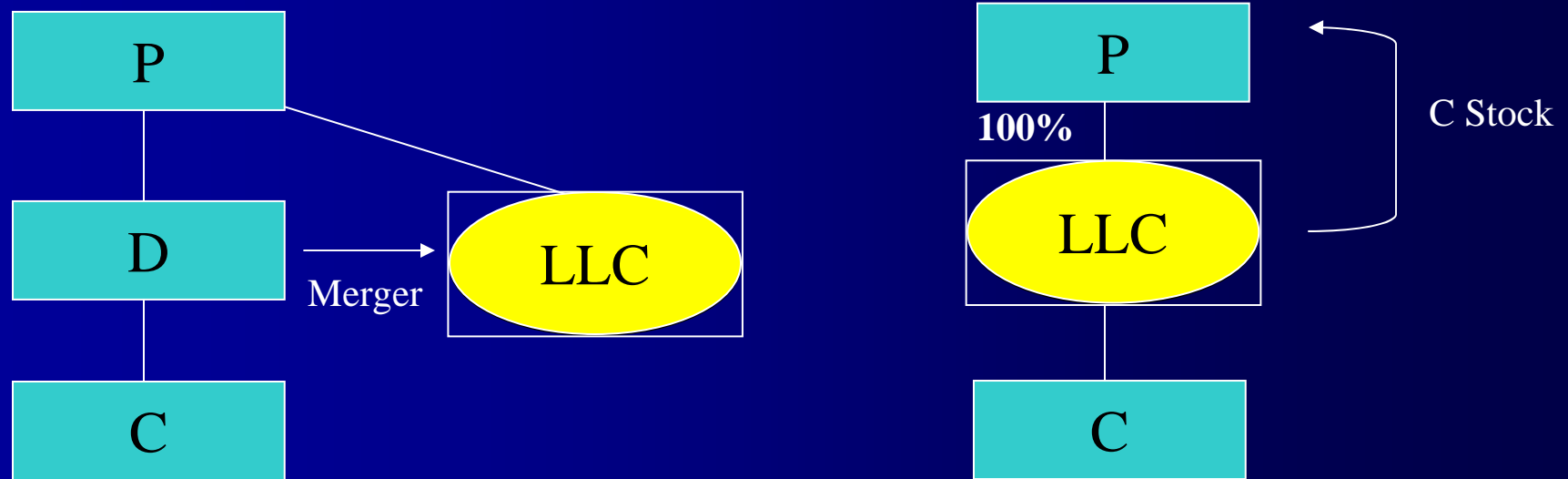


Facts: T conducts two businesses, Business A and Business B. P would like to acquire Business A in a tax-free reorganization in exchange for 80% P stock and 20% cash. T has contingent liabilities that P wants to leave behind. Further, assume for simplicity that the Business B assets have little or no built-in gain and T has a single shareholder. Accordingly, T forms a new corporation, HC, which in turn forms a wholly owned LLC treated as a disregarded entity. T transfers Business A to HC and then merges into LLC. HC then distributes the LLC interests to its shareholder in a taxable distribution. HC then merges into P, with the T shareholder receiving P stock and cash.

Result: Steps 1 and 2 should qualify as a tax-free F reorganization; step 3 should be treated as a taxable distribution of LLC's assets to T's shareholder; step 4 should qualify as a tax-free A reorganization. *See Prop. Reg. § 1.368-2(m)(3)(ii); Rev. Rul. 96-29; PLRs 199902004, 199939017.* What if, instead of a merger, the T shareholder sells the HC stock to P? *See Prop. Reg. § 1.368-2(m)(2).*

Section 355

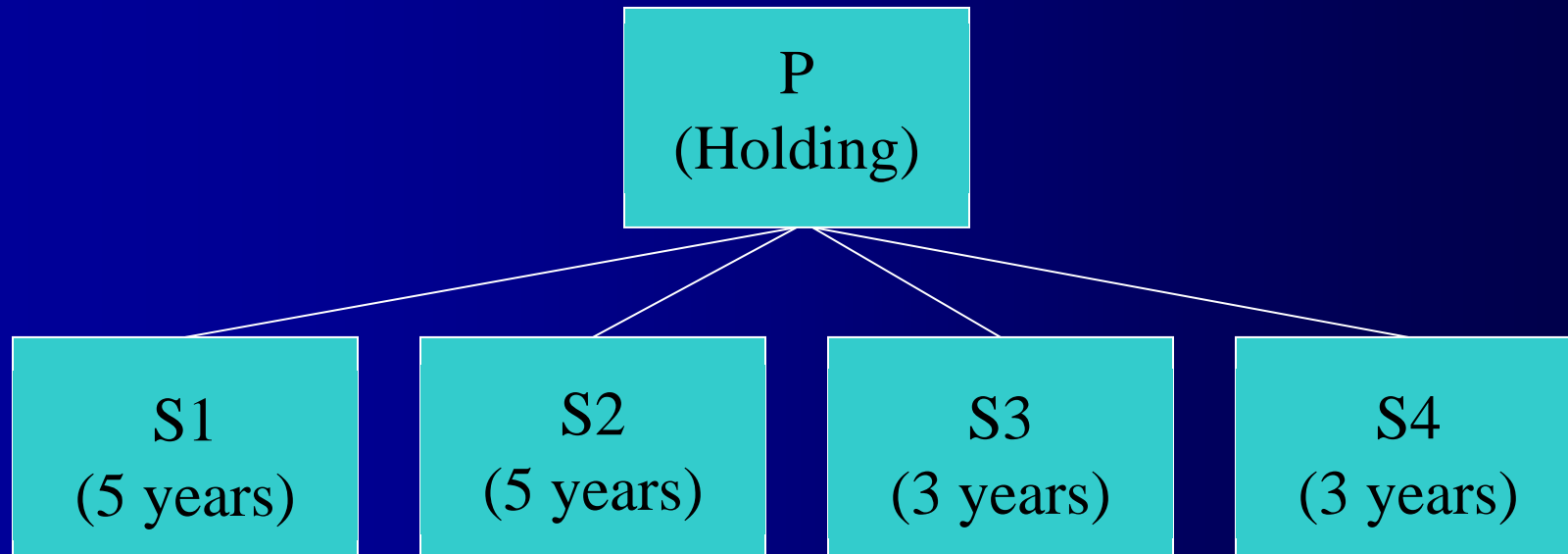
Use of LLC to Avoid Section 355



Facts: P owns all of the stock of D. D owns all of the stock of C. D wants to distribute the C stock to P, but the distribution would not satisfy the requirements of section 355. Accordingly, P forms a wholly owned LLC, which is treated as a disregarded entity, and D merges into the LLC. LLC then distributes the stock of C to P.

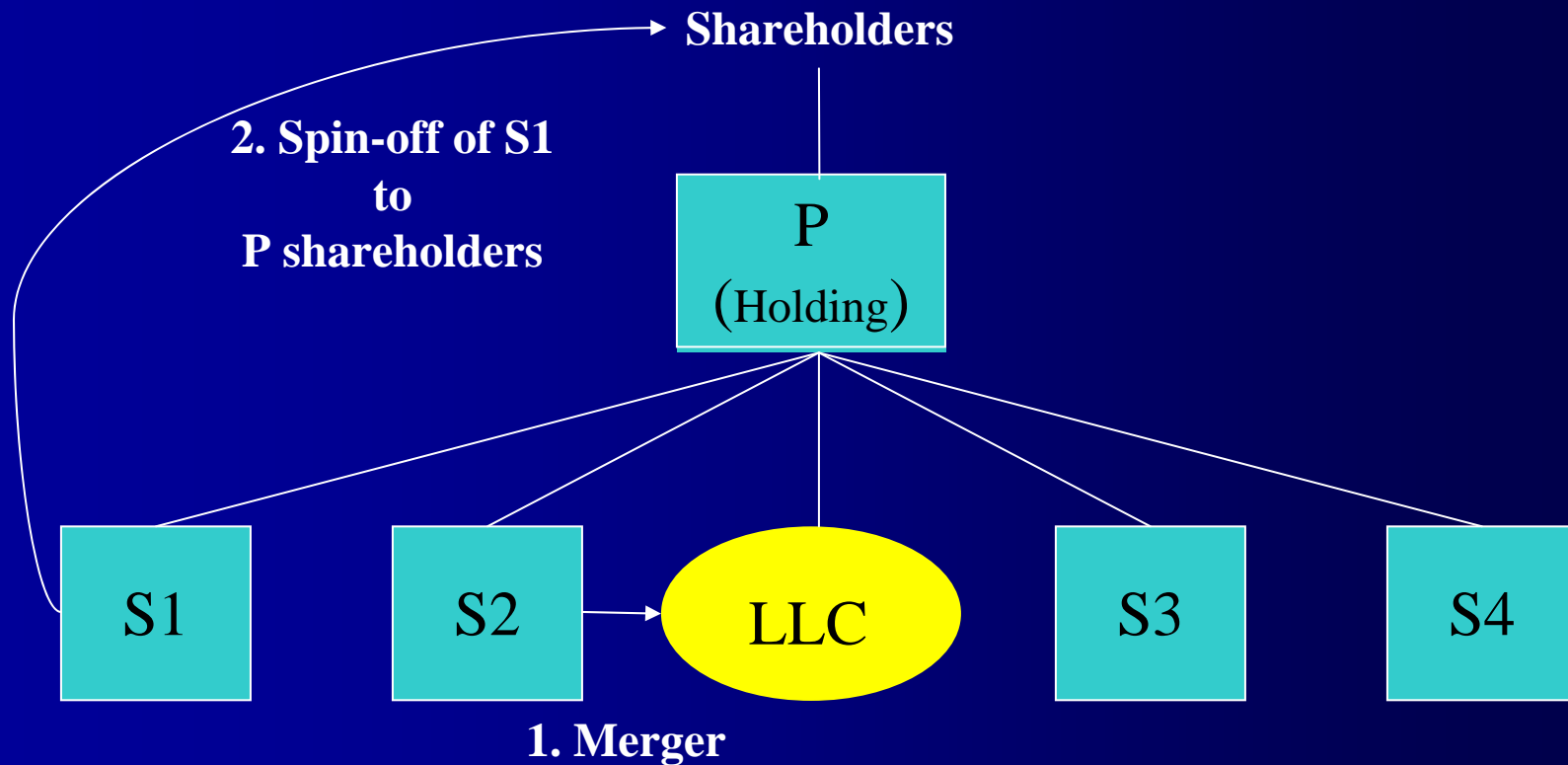
Results: D should be treated as liquidating into P in a tax-free section 332 liquidation. Because the LLC is treated as a division of P, the distribution of the C stock should be ignored. *See* PLR 200035031.

Use of LLCs in Spin-Offs



Facts: P, a holding company, has four wholly owned subsidiaries: S1, S2, S3, and S4. The subsidiaries are each actively engaged in a trade or business for purposes of section 355. S3 and S4, however, were acquired in taxable transactions during the past five years. As a result, S3 and S4 are not engaged in qualifying active businesses under section 355(b). S2 merges into an LLC. P then distributes the stock of S1 to its shareholders.

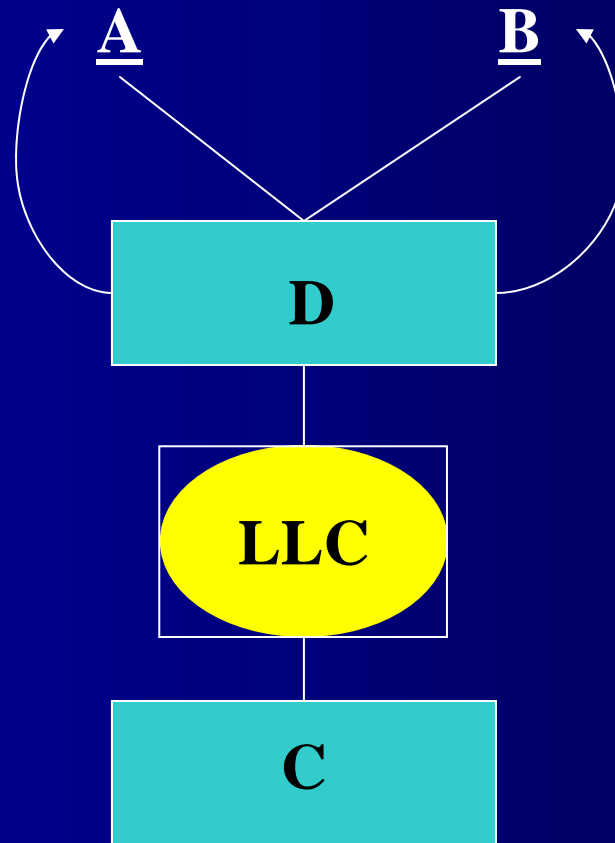
Use of LLCs in Spin-Offs (Cont.)



Results: The merger of S2 into LLC should be treated as a section 332 liquidation. Thus, P is considered to be directly conducting an active trade or business within the meaning of section 355(b).

The Tax Increase Prevention and Reconciliation Act of 2005 added new section 355(b)(3) to the Code to simplify the active trade or business requirement. Section 355(b)(3) treats all members of the distributing and controlled corporations' separate affiliated groups as one corporation for purposes of the active trade or business requirement. Thus, P is now treated as conducting the businesses of S2, S3, and S4, which eliminates LZ the need for the restructuring illustrated by this example.

Distribution of LLC Interests as a Spin-Off

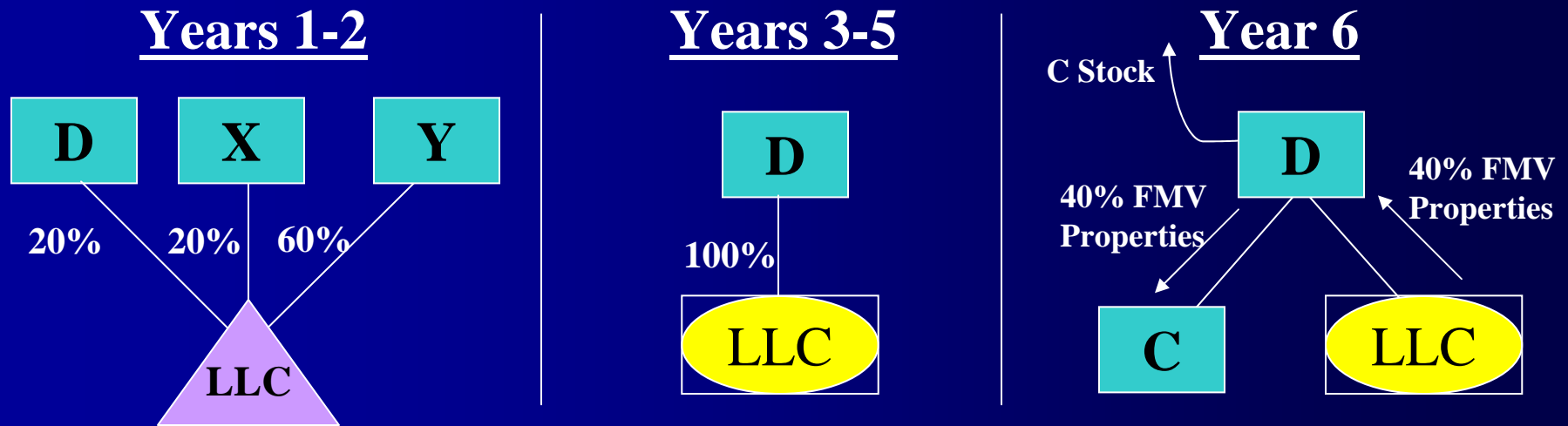


Facts: Individuals A and B own all of the stock of D. D owns all of the interests in LLC, which is disregarded as a separate entity. LLC owns all of the stock of C. D distributes all of the LLC interests to A and B.

Results: Because LLC is disregarded, the transaction should be treated as if D distributed the assets of LLC (i.e., the C stock), and A and B then contributed such assets to a partnership in exchange for partnership interests.

Section 355 and the Use of Partnerships

Revenue Ruling 2002-49: Situation 1

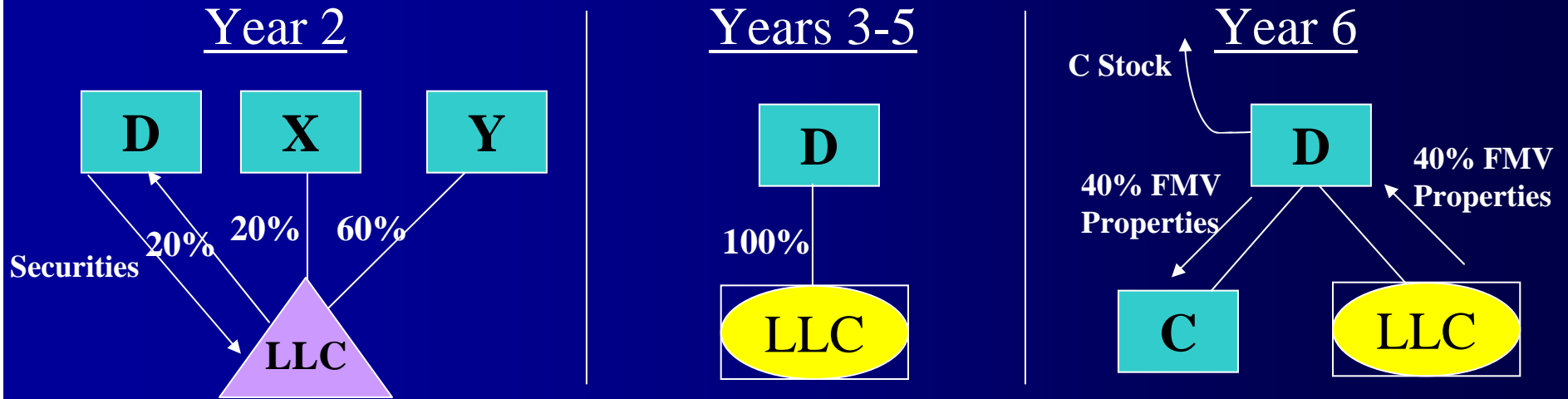


- D and X jointly perform all active and substantial management functions for LLC through Year 2.
- D purchases the LLC interests of X and Y on the first day of Year 3.
- D exclusively manages LLC from Year 3 through Year 6.
- D causes LLC to distribute 40% of the value of its rental properties on the first day of Year 6.
- D then transfers those properties to C, a newly formed subsidiary, and distributes the stock of C.

Holding: The active trade or business requirement is satisfied. In Years 1-2, D satisfies the requirements of Rev. Rul. 92-17, and the acquisition of X and Y's interests in Year 3 constitutes an expansion. See Prop. Reg. § 1.355-3(b)(2)(v)(A) and (C); - 3(d)(2), ex. 22.⁵⁹

Section 355 and the Use of Partnerships

Revenue Ruling 2002-49: Situation 2

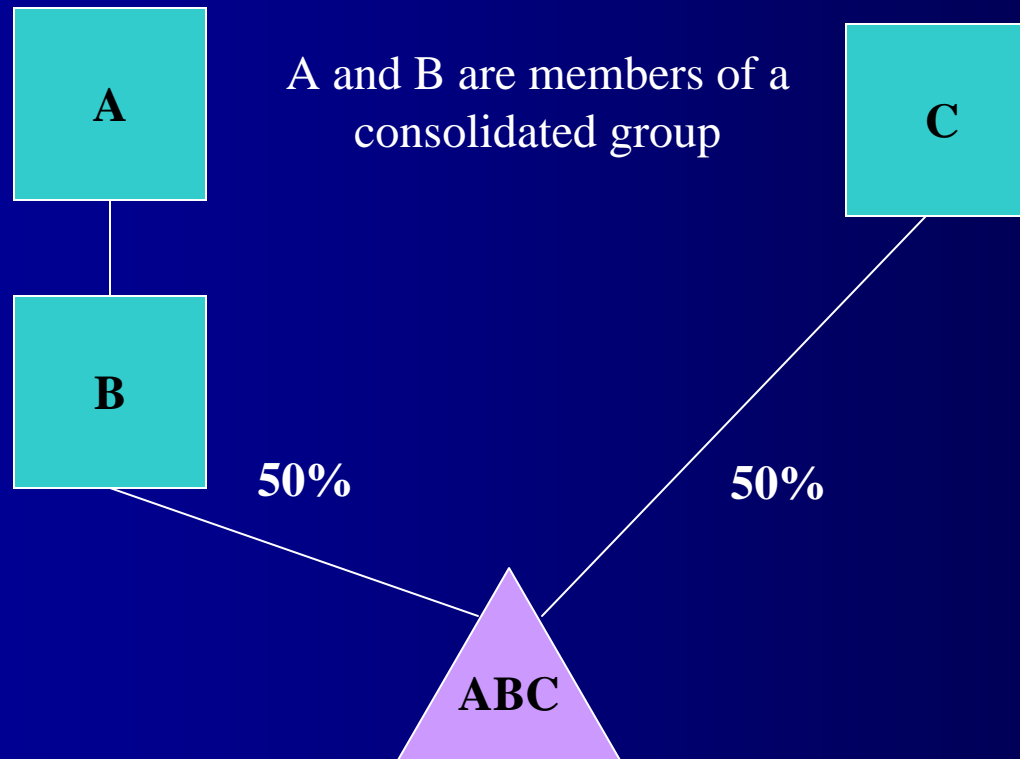


- D acquires its interest in LLC on the first day of Year 2 by contributing appreciated securities to LLC in a transaction described in Section 721.
- D and X jointly perform all active and substantial management functions for LLC through Year 2. D exclusively manages LLC from Year 3 through Year 6.
- D causes LLC to distribute 40% of the value of its rental properties on the first day of Year 6.
- D then transfers those properties to C, a newly formed subsidiary, and distributes the stock of C.

Holding: The active trade or business requirement is not satisfied because D will be treated as having acquired the business of LLC in a transaction in which gain or loss was recognized. *See also* Prop. Reg. § 1.355-3(b)(4)(ii) (providing same result).

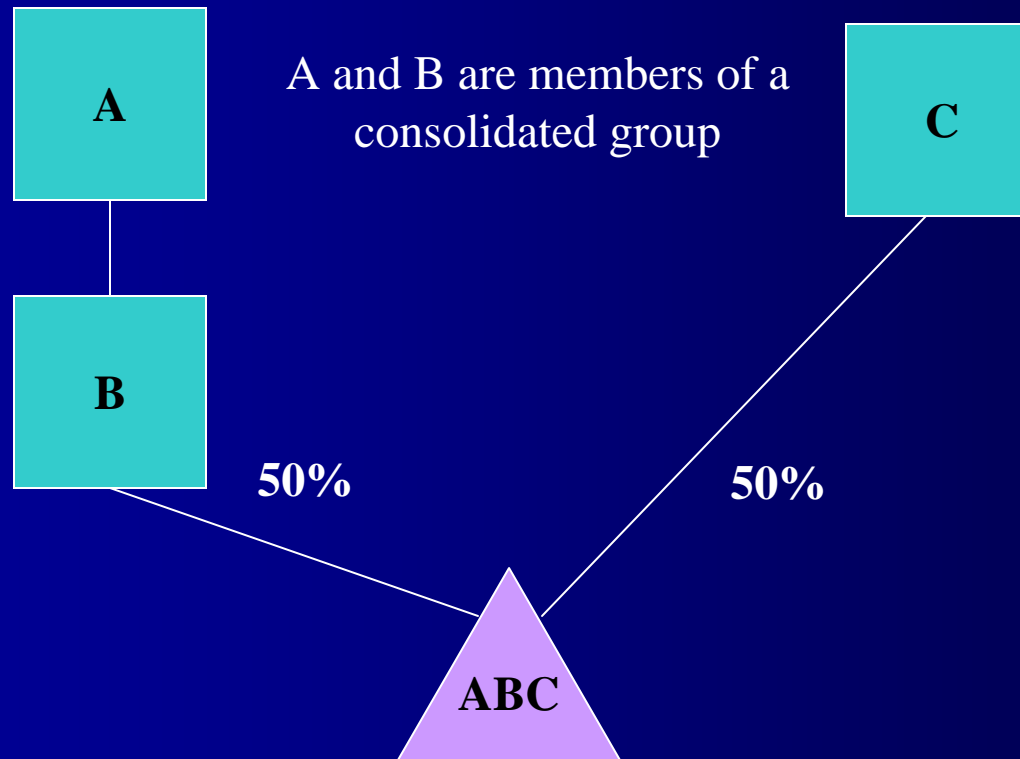
**Intragroup Liability
Allocation With
Disregarded Entities**

Intragroup Liability Allocation With Disregarded Entities



Facts: A (through B) contributes appreciated assets that are subject to a liability not in excess of basis. Such liability had been incurred less than one year earlier. In order to avoid a partial disguised sale of such assets to ABC, B guarantees 100% of the liability.

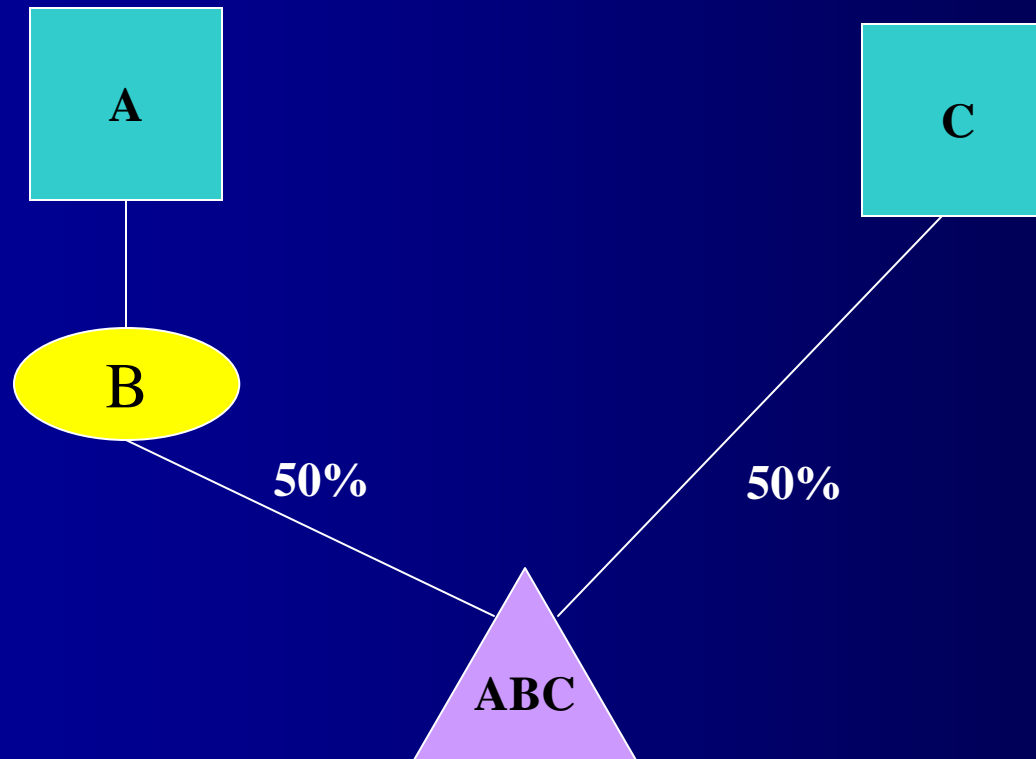
Intragroup Liability Allocation With Disregarded Entities



Query: What if B's net worth (excluding its interest in ABC) equals 50% of the liability? *See* Treas. Reg. § 1.752-2(b)(3), (6).

Query: What if B has zero net worth? *See* Treas. Reg. § 1.752-2(b)(6), (j); CCA 200246014.

Intragroup Liability Allocation With Disregarded Entities



Variation: Same facts, except that B is an LLC treated as a disregarded entity.

Query: What if B's net worth (excluding its interest in ABC) equals 50% of the liability? *See* Treas. Reg. § 1.752-2(k).

Note: Treas. Reg. § 1.752-2(k) does not apply to other types of thinly-capitalized entities (see previous slide).