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Act: 1-2011

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Text

Reference is made to your ruling request filed on November 24, 2015, on behalf of Taxpayer pursuant to the provisions of the 2011 Puerto Rico Internal Revenue Code, as amended ("Code"), Administrative Determination No. 12-04, issued on February 14, 2012 ("DA 12-04"), and Administrative Determination No. 12-09, issued on May 29, 2012 ("DA 12-09"), with respect to the Puerto Rico income tax treatment of the transaction described below.

I. STATEMENTS OF FACTS

You represented that Taxpayer is currently a limited liability company ("LLC") organized and existing under the laws of Puerto Rico, engaged in a business. Taxpayer maintains its books under the income tax basis method of accounting on the basis of a fiscal year ending on September 30th. Moreover, Taxpayer, made an election to be treated as a special partnership under the provisions of Supplement P of the income Tax Act of 1954, as amended. Taxpayer has continued to comply with all the statutory requirements to qualify as a special partnership.

Taxpayer is currently equally owned by two individual Members.

Taxpayer filed before the Puerto Rico Department of State a Certificate of Conversion from a civil partnership to a LLC pursuant to the provisions of the Act 164-2009, effective on October 1, 2015 (the "Conversion"). Taxpayer will forego its election to be treated as a special partnership in order to elect to be treated as a partnership for income tax purposes under the Code.

II. RULINGS REQUESTED

1. The Taxpayer will be considered for all purposes of the Code as the same person prior and after the Conversion.
2. No gain or loss or income will be recognized by either the Taxpayer or its members, on the Conversion from a civil partnership to a LLC pursuant to the provisions of AD 12-04.

3. No gain or loss will be recognized by the Taxpayer or its members on the deemed liquidation resulting from the change in tax treatment from a special partnership to a partnership, in pursuance with the provisions of AD 12-04 and AD 12-09 and the Code. Pursuant to the provisions of AD 12-04, the Taxpayer will, nevertheless, be subject to the recognition of any income resulting from the application of the provisions of Section 1115.08 of the Code.
4. Pursuant to the provisions of AD 12-04, the basis of the assets of the Taxpayer will be the same as the basis said assets had immediately prior to the Conversion and change in tax treatment from a special partnership to a partnership under the Code.
5. Pursuant to the provisions of AD 12-04, in determining the holding period of the property of the Taxpayer, there will be included the Taxpayer's holding period before the conversion and deemed liquidation.
6. Taxpayer's tax attributes available as of the date of the Conversion may be carried over by the partnership, in pursuance with the provisions of AD 12-04.
7. Pursuant to the provisions of Section 1071.06(b)(1)(C) of the Code, the Taxpayer will retain its current tax year due to a valid business purpose. The Taxpayer's taxable year will remain on the basis of a fiscal year ending on September 30th.
8. The effective date of the Conversion of the Taxpayer into a "partnership" subject to the provisions of Chapter 7 of the Code, will be October 1, 2015.

III. LAW AND ANALYSIS

Section 1076.01 of the Code provides the transition rules for the application of Chapter 7 of Subtitle A of the Code. This section is generally applicable to entities that, by the application of the Code or in a voluntary manner, convert from a corporation to a partnership, and provides the applicable conversion rules. However, Part III, A. of AD 12-04 specifically states that the conversion rules stated in Section 1076.01 do not apply to partnerships or LLCs that at the effective date of the Code had in effect an election as special partnership or as corporation of individuals. Instead, this Department determined that partnerships or LLCs that had in effect an election as special partnership or corporation of individuals at the effective date of the Code, may request a conversion to a partnership under Chapter 7 of Subtitle A of the Code. Under such conversion, the "new partnership" receives, in a tax-free transaction, the assets and liabilities with the same tax basis, holding period of such assets and tax attributes of the special partnership or corporation of individuals. Notwithstanding, the new partnership shall be subject to Section 1115.08 of the Code under the same terms and conditions to which the partnership or LLC was subject immediately before the conversion. The effective date of the Code for income tax purposes was the first day of the taxable commencing after

December 31, 2010, pursuant to Section 6110.04(a)(1) of the Code, which, in the Taxpayer's case, was October 1, 2011.

Furthermore, Part III, B. of AD 12-09 provides that a partnership that has in effect an election of special partnership or corporation of individuals on the effective date of the Code and subsequently elects to convert into a partnership subject to tax pursuant to Chapter 7 of Subtitle A of the Code, shall request such conversion by filing a request for an administrative determination on or before the last day of the third month following its date of conversion. Retroactive conversions shall not be granted.

The Taxpayer had a special partnership election as of the effective date of the Code for income tax purposes, which was October 1, 2011, in this case. Therefore, the conversion rules stated in Section 1076.01 of the Code are not applicable to the Taxpayer, pursuant to AD 12-04. Instead, the Taxpayer timely filed a request for administrative determination, as required under AD 12-09, to request the application of the provisions of AD 12-04, whereas the "new partnership" receives, in a tax-free transaction, the assets and liabilities with the same tax basis, holding period of such assets and tax attributes of the special partnership. Notwithstanding, the new partnership shall be subject to Section 1115.08 of the Code under the same terms and conditions to which the partnership was subject immediately before the conversion.

On the other hand, Section 1071.06(b)(1) of the Code states the general rule that the taxable year of a partnership shall be determined as though the partnership were a taxpayer. Generally, a partnership shall not have a taxable year other than (i) the majority interest taxable year; (ii) if there is no taxable year described in (i), the taxable year of all the principal partners of the partnership; or (iii) if there is no taxable year described in (i) or (ii), the calendar year unless the Secretary by regulations prescribes another period. However, a partnership may have a taxable year different from the one stated herein if it establishes, to the satisfaction of the Secretary, a business purpose. For purposes of this subparagraph, any deferral of income to partners shall not be treated as a business purpose.

The Taxpayer, prior to its conversion, had a taxable year different from its individual partners. The Taxpayer requested to keep the same tax year holding that the current accounting period guarantees the issuances of timely tax information forms to its members and government agencies; the affiliate entity has the same fiscal year and also maintains and reports financial statements under the same tax year; the change in accounting year for one of the entities will cause an undue burden and additional costs on the administration of the Taxpayer; and that maintaining the current accounting period will not result in the deferral of a substantial net loss, or a distortion of income or expense. However, the Department is currently not considering tax reporting issues as a business purpose that would permit the application of a different tax year than the one stated in Section 1071.06(b)(1) of the Code in the case of partnerships.

IV. CONCLUSION

Based solely on the facts and representations submitted for our consideration, the provisions of the Code, applicable Regulations, AD 12-04, and AD 12-09, this Department rules that:

1. The Taxpayer shall be considered for all purposes of the Code as the same person prior to and after the Conversion.
2. Effective October 1, 2015, Taxpayer election to be treated as a special partnership under the provisions of Supplement P of the Income Tax Act of 1954, as amended, shall be considered revoked. On that same date, it shall be considered that Taxpayer made the corresponding election to be taxed as a partnership under the provisions of Chapter 7 of Subtitle A of the Code.
3. No gain or loss, or income shall be recognized by either the Taxpayer or its members on the Conversion pursuant to the provisions of AD 12-04 and AD 12-09.
4. Following the Conversion, it shall be considered that the Taxpayer received all assets and liabilities of the special partnership with the same tax basis, holding period of such assets and liabilities, together with the tax attributes of the special partnership applicable before the conversion in a tax exempt transaction pursuant to AD 12-04. Therefore, no gain or loss shall be recognized by the Taxpayer or its members on the deemed liquidation resulting from the change in tax treatment from a special partnership to a partnership. Notwithstanding, the new partnership shall be subject to Section 1115.08 under the same terms and conditions to which the partnership or LLC was subject immediately before the conversion.
5. In connection with this conversion and rulings, Taxpayer shall change its taxable year to a calendar year ending on December 31, pursuant to Section 1071.06 of the Code, effective with the calendar year ended December 31, 2015. Such change of accounting period was approved by this Department on June 1, 2016.
6. The Members shall include their corresponding distributable share on Taxpayer's income for the taxable year 2015 according to the provisions of Sections 1040.10 and 1061.24 of the Code. Therefore, the Members shall include with their 2015 Individual Income Tax Return their corresponding distributable share on the Taxpayer's income for the taxable year ended September 30, 2015, and the short-period ended December 31, 2015.

Copy of this letter ruling shall be attached to the Puerto Rico income tax return of the Taxpayer for the year of the conversion.

No opinion is expressed as to the tax treatment of the above transactions under any other provision of the Code, the applicable regulations, or as to the tax treatment of any condition existing at the time of the transactions, or any effect resulting therefrom, that is not specifically covered by this ruling. The opinion expressed herein shall be valid only upon the continued existence of the facts as submitted for our consideration. This letter ruling is directed only to the Taxpayer requesting it and may not be used or cited as precedent.

Cordially,

Elisa Vélez Pérez, CPA, Esq
Assistant Secretary