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Code Sections: 1076.01

Act: 1-2011

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Text

By letter of March 31, 2015, you requested, on behalf of "Company", certain rulings with respect to the various income tax implications resulting from the conversion of Company, for income tax purposes, from an eligible entity that elected to be treated as a special partnership under the provisions of the Puerto Rico Internal Revenue Code of 1994, as amended ("1994 Code"), to a limited liability company ("LLC") that elected to be treated as a partnership under the provisions of Chapter 7 of Subtitle A of the Internal Revenue Code for a New Puerto Rico, as amended ("Code").

I. STATEMENTS OF FACTS

Company was originally organized as a corporation under the laws of Puerto Rico. Since its inception, which was more than ten (10) years ago, the Company elected to be treated as a special partnership ("Election") pursuant to Sections 1330 and 1342 of the 1994 Code. At December 31, 2014, the Election was still in effect.

Company is equally owned by two individuals with a calendar taxable year.

On 2011, Company converted to LLC in accordance to the terms of Article 19.16 of the General Corporations Law, Act 164 of December 16, 2009, as amended (the "General Corporations Law"), and changed its name accordingly (the "Conversion").

II. RULINGS REQUESTED

1. Pursuant to Section 1114.11(a) of the Code, effective for the taxable year commencing on or after January 1, 2015, the Company's Election will be considered voluntarily revoked.
2. Pursuant to Section 1010.01(a)(3) of the Code, the Company will be treated, for tax purposes, as a partnership, for taxable year commenced on January 1, 2015, and ending on December 31, 2015, and thereafter.

3. Pursuant to AD 12-04, the "new partnership" will receive the assets and liabilities of the Company with the same tax basis, holding period of assets, and tax attributes applicable before the conversion.
4. Pursuant to AD 12-04, the conversion for tax purposes of the Company into a partnership will be considered a tax exempt transaction.
5. Since the Company had the Election since its inception, the provisions of Section 1115.08 of the Code will not be applicable.
6. The Company's taxable yearend for the "new partnership" will continue to be December 31st.

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

Specifically, Part III, A., 3. of AD 12-09 provides that when an entity organized as a corporation converts, in accordance with the General Corporations Law, into a LLC in a transaction that complies with the requirements of Section 1034.04(g)(1)(F) of the Code, the resulting LLC shall not be treated as a new LLC. Furthermore, if the corporation to be converted into a LLC in a transaction that complies with the requirements of Section 1034.04(g)(1)(F) of the Code has in effect a special partnership or corporation of individuals election at the time of the conversion and such LLC elects to be treated, for purposes of the Code, as a partnership, starting on the date of such conversion, it shall request the same by filing a request for an administrative determination, on or before the last day of the third month following its date of conversion.

Section 1034.04(g)(1) of the Code provides the definition of a "reorganization" for purposes of the Code. A transaction categorized as a reorganization under the Code has distinct income tax rules under the Code. Reorganizations include different types of transactions, as described in Section 1034.04(g)(1) of the Code. Specifically, Section 1034.04(g)(1)(F) of the Code states that the term "reorganization" includes a mere change in identity, form, or place of organization of one corporation, however effected. Article 1112(g)-2 of the Regulations under the 1994 Code provides that a reorganization under Section 1112(g)(1)(F) of the 1994 Code, precursor of Section 1034.04(g)(1)(F) of the Code requires that there be a continuity of the same business and operations that were carried on by the corporation prior to the change. Since Section 1034.04(g)(1)(F) of the Code reads identical to Section 1112(g)(1)(F) of the 1994 Code, Article 1112(g)-2 of the Regulations under the 1994 Code are still in effect, pursuant to Section 6091.01(a) of the Code.

Article 1342-1(e) of the Regulations under the 1994 Code states that a special partnership election realizing a reorganization described in Section 1112(g)(1)(F) of the 1994 Code, shall be considered transferred to the acquiring partnership or corporation and will continue in effect after the reorganization, provided that it is notified to the Internal Revenue Area of the Department. The Conversion qualifies as a reorganization under Section 1034.04(g)(1)(F) of the Code. Therefore the special partnership election was transferred from the corporation to the LLC created in 2011 by means of the Conversion.

Furthermore, Article 19.16 of the General Corporations Law with regards to the conversion from a corporation to a LLC, states that, except agreement to the contrary, or as required by the applicable laws in Puerto Rico, the converting entity shall not be required to liquidate its matters or pay its debts and distribute its assets, and it shall not be considered that the conversion constitutes a dissolution of the entity and shall constitute the continuation of the existence of the converting entity. When an entity has converted in a limited liability company pursuant to Article 19.16 of the General Corporations Law, it shall be considered for all purposes of the laws in Puerto Rico as the same entity that is converting.

The Company had a special partnership election as of the effective date of the Code for income tax purposes, which was January 1, 2011, in this case. The Company converted in 2011 from a corporation to a partnership in a transaction that complies with the requirements of Section 1034.04(g)(1)(F) of the Code. However, the Election is not made effective until January 1, 2015, since it was requested on March 31, 2015. 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 filed a request for administrative determination, as required under AD 12-09, to request the application of the provisions of AD 12-04.

Section 1115.08 of the Code provides that if for any taxable year beginning in the recognition period a corporation of individuals has a net recognized built-in gain, there shall be imposed a tax (computed as stated in such section) on the income of such corporation for such taxable year. The recognition period is ten (10) years beginning with

the first day of the first taxable year for which the corporation was a corporation of individuals. Sections 1342 of the 1994 Code and 1114.12 of the Code applies the same rule to entities with a special partnership election.

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 taxable year of the Company complies with the rules prescribed in Section 1071.06(b)(1) of the Code.

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. Pursuant to Section 1114.11(a) of the Code, effective for taxable years commencing on or after January 1, 2015, the Company's Election will be considered voluntarily revoked.
2. Pursuant to Section 1010.01(a)(3) of the Code, the Company will be treated, for tax purposes, as a partnership, for taxable year commenced on January 1, 2015, and ending on December 31, 2015, and thereafter.
3. Pursuant to AD 12-04, the "new partnership" will receive the assets and liabilities of the Company with the same tax basis, holding period of assets, and tax attributes applicable before the conversion.
4. Pursuant to AD 12-04, the conversion of the Company into a partnership will be considered a tax exempt transaction for tax purposes.
5. Since the Company had the Election since its inception, the provisions of Section 1115.08 of the Code are not applicable.
6. The Company's taxable year-end for the "new partnership" will continue to be December 31st.

Copy of this letter ruling shall be attached to the Puerto Rico income tax return of the Company for the year ending on December 31, 2015.

No opinion is expressed as to the tax treatment of the above transaction under any provisions of the 2011 Code, or the regulations thereunder, that may also be applicable thereto, or to the tax treatment of any condition existing at the time or any effect resulting therefrom, that is not specifically covered by this ruling. This ruling is based on the factual representations as described above. Any misrepresentation or hiding of a material fact shall render this ruling null and void. 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 Company requesting it and may not be used or cited as precedent.

Cordially,

Victor Pizarro Núñez, CPA, Esq
Assistant Secretary
Internal Revenue Area

