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Topic: Income Tax - Partnerships

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Text

Reference is made to your letter dated November 14, 2013, wherein you requested on behalf of "Company A" and "Company B", our rulings in connection with the Puerto Rico income tax treatment of the transactions described below under the provisions of the Puerto Rico Internal Revenue Code of 2011, as amended, ("Code").

I. STATEMENTS OF FACTS

You represented that Company A was a limited liability company organized under the laws of the State X and authorized to do business in Puerto Rico, whose sole member was Company B. For federal income tax purposes, Company A was treated as a disregarded entity. For Puerto Rico income tax purposes, Company A, which was a resident foreign entity, was taxed as a partnership.

Company B is a corporation organized and existing under and by virtue of the laws of the State X and duly authorized to do business in Puerto Rico. Company B is engaged in the same business in which Company A was engaged and in which all operating assets and liabilities of Company A that were transferred to Company B are being used. For Puerto Rico income tax purposes, Company B is a foreign corporation engaged in a trade or business in Puerto Rico. Company A's and Company B's taxable year ends on December 31. Company B was the sole member/partner of Company A. Company B acquired Company A as a result of a taxable stock acquisition.

Company B acquired in a taxable transaction 100% of the membership interest in Company A ("Company A Acquisition"). For Puerto Rico income tax purposes, the Company A Acquisition was treated as a termination of an "old partnership" and the continuation of the business by a "new partnership" pursuant to Section 1071.08(b)(1)(B) of the Code. Company A indicated that it intended to make an election under Section 1075.04 of the Code with regards to the Company A Acquisition in the corresponding income tax return.

On the "Effective Date", which was two months after the Company A Acquisition date, Company A was merged with and into its sole member, Company B, with Company B being the surviving entity, in a statutory merger pursuant to an agreement of merger that was duly adopted under the laws of the State X on the same date (the "Transaction"). By operation of law, all of Company A's Puerto Rico assets and liabilities were transferred to Company B. Immediately after the merger, Company A ceased to exist as a legal entity.

The agreement of merger was duly approved by resolutions adopted by the Board of Managers of Company A and by the sole member of Company A (i.e., Company B), and by resolutions adopted by the Board of Directors of Company B and by the sole stockholder of Company B. A Certificate of Merger was filed with the Department of State X. A certificate of cancellation of a foreign limited liability company ("Certificate of Cancellation") was filed with the Puerto Rico Department of State effective on the Effective Date.

For Puerto Rico income tax purposes, the Transaction was treated as a distribution of partnership assets, subject to the liabilities, to its sole corporate partner, Company B, in complete liquidation of its partnership interest in the partnership (that is, Company A) since Company A was classified and taxed as a partnership, for Puerto Rico income tax purposes, for the taxable year in which the merger took place.

The partnership assets that were transferred to Company B as the result of the Transaction were: (1) Cash; (2) Accounts Receivable; (3) Inventory; (4) Other Current Assets; (5) Property, Plant and Equipment; and (6) Goodwill.

You further stated that the Transaction described above is not in pursuance of a plan having as one of its purposes the avoidance of Puerto Rico income taxes within the meaning of Section 1034.04(i) of the Code. Although all Company A's Puerto Rico assets, subject to the liabilities, were distributed to Company B, such Puerto Rico assets stayed, as a matter of fact, within Puerto Rico. Said assets are currently being used by Company B within Puerto Rico in the same line of business in which Company A was engaged prior to its complete liquidation. The business purpose of the complete liquidation of Company A was to simplify the organizational structure for conducting the Puerto Rico operations. The new corporate structure will be easier and less expensive to administer because one legal entity (i.e. Company A) was eliminated. There will be one less audit report and tax return, and fees associated with maintaining Company A's legal presence because one legal entity was eliminated.

II. RULINGS REQUESTED

1. The Transaction is not in pursuance of a plan having as one of its purposes the avoidance of Puerto Rico income taxes under the Code.

2. For Puerto Rico income tax purposes, Company A is a partnership within the meaning of Section 1070.01(a)(2) of the Code and Company B is a partner within the meaning of Section 1070.01(b) of the Code.
3. For Puerto Rico income tax purposes, the Transaction will be treated as a distribution of partnership assets by Company A to its sole partner Company B in complete liquidation of Company B's interest in Company A within the meaning of Section 1070.01(d) of the Code.
4. For Puerto Rico income tax purposes, Company A's taxable year closed on the effective date of the Transaction in accordance with Section 1071.06(c) of the Code.
5. No gain or loss will be recognized by Company A upon the distribution of its property to Company B, including money, in complete liquidation of Company B's interest in Company A, pursuant to Section 1073.01(b) of the Code.
6. No gain will be recognized by Company B upon its receipt of property as a result of the distribution made by Company A in complete liquidation of Company B's interest in Company A, except to the extent that any money distributed exceeds the adjusted basis of Company B's interest in Company A immediately before the distribution, pursuant to Section 1073.01(a)(1) of the Code.
7. No loss will be recognized by Company B upon its receipt of property as a result of the distribution made by Company A in complete liquidation of Company B's interest in Company A since property other than cash, inventory or unrealized receivables ("other property") were distributed to Company B, pursuant to Section 1073.01(a)(2) of the Code. Recognition of any loss will be deferred until Company B sells or disposes of the "other property" in a taxable transaction.
8. Any gain recognized by Company B in the Transaction will be considered a gain realized from the sale or exchange of a capital asset, pursuant to Section 1073.01(a) of the Code.
9. The basis in the hands of Company B of each asset (other than money) received from Company A in the Transaction will be equal to the adjusted basis of Company B's interest in Company A, reduced by any money distributed in the same Transaction, pursuant to Section 1073.02(b) of the Code.
10. The basis of the distributed assets to Company B in liquidation of its interest in Company A, as determined pursuant to Section 1073.02(b) of the Code, will be allocated among said assets in accordance with the provisions of Section 1073.02(c) of the Code.
11. To the extent that no Section 1075.04 election is deemed to be in effect with respect to the Company A Acquisition, Company B may elect to treat as the adjusted partnership basis of the property (other than money) distributed to Company B in the Transaction the adjusted basis such property would have if the adjustment provided in Section 1074.03(b) of the Code were in effect with respect to the partnership property, in accordance with Section 1073.02(d) of the Code.

12. The holding period Company B will have in each asset acquired from Company A in the Transaction will include the period during which that asset was held by Company A pursuant to Sections 1073.05(b) and 1034.01(g) of the Code.
13. Section 1062.08(f) of the Code shall not apply to Company A's filing with the Secretary of State of Puerto Rico a surrender of its right to do business in Puerto Rico pursuant to the General Corporation Law of Puerto Rico in connection with and incident to the Transaction.

III. LAW AND ANALYSIS

Section 1070.01(a) of the Code states that, for purposes of Subtitle A of the Code (Income Taxes), the term "partnership" includes a syndicate, group, mutual fund, joint venture or any other unincorporated organization through or by means of which any business, financial operation or venture is carried on, and which is not, for purposes of this subtitle, a corporation, a trust or estate. The term "partnership" also includes those limited liability companies that, as provided in Section 1010.01(a)(3) of the Code, are subject to tax under the provisions of Chapter 7 (Partnerships) for income tax purposes. The term "partner" is defined in Section 1070.01(b) of the Code as any member of a partnership. The term "partner" includes a member of a limited liability company that is subject to tax as a partnership for income tax purposes, pursuant to section 1010.01(a)(3).

Section 1010.01(a)(3)(A) of the provides that every limited liability company that by reason of its election or provision of law or regulation under the Federal Internal Revenue Code of 1986, Title 26 of the United States Code, as amended (the "US IRC"), or similar provision of a foreign country, is treated as a partnership or whose income and expenses are attributed to its members for federal income tax purposes or that of the foreign country, as in Company A's case, shall be treated as a partnership for purposes of Subtitle A of the Code, subject to the provisions of Chapter 7 of Subtitle A of the Code.

As represented, Company A was a limited liability company organized under the laws of the State X and authorized to do business in Puerto Rico whose income and expenses are attributed to its members for federal income tax purposes as a disregarded entity. Therefore, Company A shall be treated as a partnership for Puerto Rico income tax purposes, and Company B, as its sole member, shall treated as its partner, pursuant to Section 1070.01(a) and (b) of the Code.

Section 1070.01(d) of the Code states that for purposes of Chapter 7 of Subtitle A of the Code, the term "liquidation of the partner's interest" means the termination of the total interest in a partnership by means of a distribution or a series of distributions to a partner by the partnership. On the Effective Date, Company A merged with and into Company B, with Company B being the surviving entity. By operation of law, all of Company A's Puerto Rico assets and liabilities were transferred or distributed to Company B to complete the liquidation of Company B's interest in Company A.

Section 1071.06(c) of the Code states that except in the case of a termination of a partnership, the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership. Section 1071.08(b)(1)(A) of the Code states that a partnership shall be considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership. Company A was legally terminated on the Effective Date since its member will no longer continue the financial operation through the partnership. Therefore, the taxable year of Company A was closed on the Effective Date.

Section 1073.01(b) of the Code provides that no gain or loss shall be recognized to a partnership on a distribution to a partner of property, including money. Accordingly, Company A shall not recognize gain on distribution of its properties to Company B as a result of its liquidation.

Section 1073.01(a) of the Code states that in the case of a distribution by a partnership to a partner, gain shall not be recognized to such partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution. Similarly, loss shall generally not be recognized to such partner. However, in the case of a total liquidation of a partner's interest in a partnership, if the property distributed is money, any unrealized receivables (as defined in Section 1075.01(c) of the Code) or inventory (as defined in Section 1075.01(d) of the Code), loss shall be recognized to the extent the adjusted basis of such partner's interest in the partnership (determined under Section 1073.02 of the Code) exceeds the sum of the money received and the partner's basis in such assets. Any gain or loss recognized under Section 1073.01(a) of the Code shall be considered as gain or loss from the sale or exchange of a capital asset. Company A's liquidating distribution to Company B shall be subject to Section 1073.01(a) of the Code.

Section 1073.02(b) of the Code states that the basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction. Accordingly, Section 1073.02(c) of the Code provides the rules for the allocation of the tax basis.

However, for purposes of calculating the adjusted basis of the partnership property, a partner who acquired all or a part of his interest by a transfer with respect to which the election provided in Section 1075.04 of the Code is not in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within two (2) years after such transfer, may elect to treat as the adjusted partnership basis of such property the adjusted basis such property would have if the adjustment provided in Section 1074.03(b) of the Code were in effect with respect to the partnership property. Section 1074.03(b) of the Code permits to increase the adjusted basis of the partnership property by the excess of the basis to the partner of his interest in the partnership over his proportionate share of the adjusted basis of the partnership property,

or to decrease the adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of his interest in the partnership.

Section 1075.04 provides an election to calculate the basis of partnership property in the case of a distribution of property, in the manner provided in Section 1073.04 of the Code and, in the case of a transfer of a partnership interest, in the manner provided in Section 1074.03 of the Code. Section 1075.04 of the Code was adopted from Section 754 of the US IRC, which provides for a similar election for United States income tax purposes. No regulations under Section 1075.04 of the Code are currently in effect. However, Regulation Section 1.754-1 under the US IRC ("Reg. 1.754-1") provides that the election under Section 754 of the US IRC shall be made in a written statement filed with the partnership return for the taxable year during which the distribution or transfer occurs. For the election to be valid, the return must be filed not later than the time prescribed by [the applicable provision] (including extensions thereof) for filing the return for such taxable year. Should the Department adopt the same rule provided under Reg. 1.754-1, any election under Section 1075.04 of the Code filed after the due date for filing the corresponding income tax return, with regards to the Company A Acquisition, will be deemed filed late, and therefore, not valid.

Accordingly, Company B may calculate the tax basis of the assets received in Company A's liquidation according to the rules provided under Section 1073.02(b) and (c) of the Code. However, to the extent that no election under Section 1075.04 of the Code is deemed to be in effect with respect to the Company A Acquisition, Company B may elect to calculate the adjusted basis that the partnership would have had in the property as if an election under Section 1073.02(d) of the Code were in effect, since the liquidating distribution was made within two (2) years after the Company A Acquisition.

Section 1073.05(b) of the Code provides that in determining the period for which a partner has held property received in a distribution from a partnership (other than in the case of unrealized receivables and inventory items), the provisions of Section 1034.01(g) of the Code shall apply. Section 1034.01(g) provides that in determining the period for which the taxpayer has held property, however acquired, there shall be included the period during which such property was held by any other person, if under the provisions of Section 1072.01, among others, such property has, for purposes of determining gain or loss from a sale or exchange, the same basis, in whole or in part, in his hands as it would have in the hands of such other person. In order to calculate the holding period of the assets distributed, Company B must apply the rules provided in Sections 1073.05(b) and 1034.01(g) of the Code.

Section 1062.08(f) of the Code requires a foreign corporation that has filed with the Secretary of State of Puerto Rico a surrender of its right to do business in Puerto Rico, pursuant to the General Corporation Law of the Government of Puerto Rico to withhold from its shareholders and pay to the Secretary the corresponding tax in the same manner as if the undistributed amount of its earnings and profits from sources in Puerto Rico (including the earnings and profits attributable to the period comprised between the close

of the last taxable year and the date on which the corporation gave notice to the Secretary of State of its withdrawal from Puerto Rico) had actually been distributed as dividends in the year in which such surrender of right has been filed. As a partnership, Company A had no undistributed earnings and profits from sources in Puerto Rico at the time of its liquidation. Therefore, Section 1062.08(f) is not applicable to Company A.

IV. CONCLUSION

Based solely on the facts, representations, and documents submitted for our consideration, the provisions of the Code and the Regulation issued under the Code, this Department rules that:

1. The Transaction is not in pursuance of a plan having as one of its purposes the avoidance of Puerto Rico income taxes under the Code.
2. For Puerto Rico income tax purposes, Company A is a partnership within the meaning of Section 1070.01(a)(2) of the Code and Company B is a partner within the meaning of Section 1070.01(b) of the Code.
3. For Puerto Rico income tax purposes, the Transaction will be treated as a distribution of partnership assets by Company A to its sole partner Company B in complete liquidation of Company B's interest in Company A within the meaning of Section 1070.01(d) of the Code.
4. For Puerto Rico income tax purposes, Company A's taxable year closed on the Effective Date of the Transaction in accordance with Section 1071.06(c) of the Code.
5. No gain or loss will be recognized by Company A upon the distribution of its property to Company B, including money, in complete liquidation of Company B's interest in Company A, pursuant to Section 1073.01(b) of the Code.
6. No gain will be recognized by Company B upon its receipt of property as a result of the distribution made by Company A in complete liquidation of Company B's interest in Company A, except to the extent that any money distributed exceeds the adjusted basis of Company B's interest in Company A immediately before the distribution, pursuant to Section 1073.01(a)(1) of the Code.
7. No loss will be recognized by Company B upon its receipt of property as a result of the distribution made by Company A in complete liquidation of Company B's interest in Company A since property other than cash, inventory or unrealized receivables ("other property") were distributed to Company B, pursuant to Section 1073.01(a)(2) of the Code. Recognition of any loss will be deferred until Company B sells or disposes of the "other property" in a taxable transaction.

8. Any gain recognized by Company B in the Transaction will be considered a gain realized from the sale or exchange of a capital asset, pursuant to Section 1073.01(a) of the Code.
9. The basis in the hands of Company B of property distributed (other than money) received from Company A in the Transaction will be equal to the adjusted basis of Company B's interest in Company A, reduced by any money distributed in the same Transaction, pursuant to Section 1073.02(b) of the Code.
10. The basis of the distributed assets to Company B in liquidation of its interest in Company A, as determined pursuant to Section 1073.02(b) of the Code, will be allocated among said assets in accordance with the provisions of Section 1073.02(c) of the Code.
11. To the extent that no Section 1075.04 election is deemed to be in effect with respect to the Company A's Acquisition, Company B may elect to treat as the adjusted partnership basis of the property (other than money) distributed to Company B in the Transaction the adjusted basis such property would have if the adjustment provided in Section 1074.03(b) of the Code were in effect with respect to the partnership property, in accordance with Section 1073.02(d) of the Code.
12. The holding period Company B will have in each asset acquired from Company A in the Transaction will include the period during which that asset was held by Company A pursuant to Sections 1073.05(b) and 1034.01(g) of the Code.
13. Section 1062.08(f) of the Code shall not apply to Company A's filing with the Secretary of State of Puerto Rico a surrender of its right to do business in Puerto Rico pursuant to the General Corporation Law of Puerto Rico in connection with the incident to the Transaction.

No opinion is expressed as to the tax treatment of the above transaction under any provisions of the 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 taxpayer requesting it and may not be used or cited as precedent.

Cordially,

Victor Pizarro Núñez
Assistant Secretary
Internal Revenue Area