Internal Revenue Service

Index No. 0721.00-00

Department of the Treasury

Washington, DC 20224

199901028

Contact Person:

Telephone Number:

In Reference to:
CC:DOM:P&SI:3 / PLR-113101-98

Date:
OCT 13 1998

Legend

Partnership =

A =

B =

C =

D =

E =

F =

Trust =

x =

y =

z =

This letter responds to a letter, dated June 18, 1998, that was submitted by your authorized representative, requesting a private letter ruling concerning the federal income tax consequences of proposed contributions of property to Partnership.

The information submitted indicates that A, B, C, and D are equal beneficiaries of Trust. Trust plans to distribute all of its assets to the beneficiaries. Thus, A, B, C, and D will each receive an undivided, identical one-fourth interest in each asset of Trust. A, B, C, and D propose to contribute these assets to Partnership. In exchange for the assets, A, B, C, and D will each receive an x percent limited interest in Partnership. E and F, the parents of A, B, C, and D, plan to contribute cash to Partnership in exchange for a y percent interest in Partnership.

The Service has been requested to rule that no gain will be recognized by A, B, C, D, E, F, or Partnership under § 721 of the Internal Revenue Code on the transfer of the assets to Partnership.

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

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

Section 351(a) provides that no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange the transferors are in control (as defined in § 368(c)) of the corporation.

Section 351(e)(1) provides that § 351 will not apply to transfers of property to an investment company. Under § 1.351-1(c)(1) of the Income Tax Regulations, a transfer of property after June 30, 1967, will be considered to be a transfer to an investment company if (i) the transfer results, directly or indirectly, in diversification of the transferors' interests, and (ii) the transferee is (a) a regulated investment company, (b) a real estate investment trust, or (c) a corporation more than 80 percent of the value of whose assets (excluding cash and nonconvertible debt obligations) are held for investment and are readily marketable stocks or securities, or interests in regulated investment companies or real estate investment trusts.

Section 1002 of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997) (the "Act"), amended § 351(e) for transfers after June 8, 1997, in taxable years ending after such date, subject to certain transitional relief provisions. Section 1002 of the Act is intended to expand the types of assets

considered in determining whether a transfer is to a transferee described in § 1.351-1(c)(1)(ii)(c) to include certain assets in addition to "readily marketable stocks or securities" and interests in regulated investment companies and real estate investment trusts. However, the Act is not intended to alter the requirement of § 1.351-1(c)(1)(i) that a transfer of property will be considered to be a transfer to an investment company under § 351(e) only if the transfer results, directly or indirectly, in the diversification of the transferors' interests. See S. Rep. No. 33, 105th Cong., 1st Sess. 131 (1997); H.R. Rep. No. 148, 105th Cong., 1st Sess. 447 (1997); H.R. Rep. No. 220, 105th Cong., 1st Sess. 516-17 (1997). It has been represented that, for purposes of § 1.351-1(c)(1)(ii)(c), as amended by the Act, Partnership would qualify as an investment company if it were incorporated.

Section 1.351-1(c)(2) provides that the determination of whether a corporation is an investment company is ordinarily made by reference to the circumstances in existence immediately after the transfer in question. However, § 1.351-1(c)(2) also provides that where circumstances change thereafter pursuant to a plan in existence at the time of the transfer, this determination will be made by reference to the later circumstances.

Section 1.351-1(c)(5) provides that a transfer ordinarily results in the diversification of the transferors' interests if two or more persons transfer nonidentical assets in the exchange. For this purpose, if any transaction involves the transfer of one or more transfers of nonidentical assets, which taken in the aggregate, constitutes an insignificant portion of the total value of assets transferred, then such transfers are disregarded for purposes of determining whether diversification has occurred. If a transfer is part of a plan to achieve diversification without recognition of gain, such as a plan which contemplates a subsequent transfer, however delayed, of the corporate assets (or of the stock or securities received in the earlier exchange) to an investment company in a transaction purporting to qualify for nonrecognition treatment, the original transfer will be treated as resulting in diversification.

The determination of what constitutes an "insignificant portion" of the total value of transferred assets is a factual issue. See Rev. Rul. 87-9, 1987-1 C.B. 133 (holding that the transfer of a nonidentical asset (cash) constituting 11 percent of the total value of the transferred assets in a § 351 exchange was not an "insignificant portion" for purposes of § 1.351-1(c)(5)). Example 1 of § 1.351-1(c)(7) illustrates that in a situation where two percent of the total assets transferred are nonidentical, the two percent transfer is "insignificant" and therefore disregarded for purposes of determining whether diversification has occurred.

In the present case, z percent of the assets transferred to Partnership are the four undivided and identical interests in the assets currently held by Trust. Only y percent of the total assets transferred to the Partnership, the cash from E and F, are nonidentical assets. Under these facts, the transfer of cash constitutes an insignificant portion of the total value of the assets transferred and will be disregarded for purposes of the diversification requirement of § 1.351-1(c)(1)(i).

Accordingly, after applying the law to the facts submitted and representations made, we conclude that the proposed contributions to Partnership by A, B, C, and D of their undivided, identical interests in the assets to be distributed by Trust and the contribution of cash by E and F will not be treated as transfers to an investment company within the meaning of § 351(e). Therefore, no gain will be recognized by A, B, C, D, E, F, or Partnership on the proposed contribution of assets to Partnership in exchange for interests in Partnership under § 721.

Except as otherwise provided, we express no opinion regarding the federal income tax treatment of the proposed transaction under any other provision of the Code or regulations. Specifically, no opinion is expressed as to whether the transaction is part of a plan to achieve diversification without recognition of gain under § 1.351-1(c)(5). Furthermore, no opinion is expressed concerning estate and gift tax valuation issues that may arise regarding transfers of partnership interests.

This letter is directed only to the taxpayers who requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

Under the power of attorney on file in this office, a copy of this letter is being sent to Partnership's authorized representative.

Sincerely yours,

Jeff Erickson

Jeff Erickson
Assistant to the Branch Chief
Branch 3
Office of Assistant Chief Counsel
(Passthroughs & Special Industries)

Enclosure
Copy for section 6110 purposes