

part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§1.411(d)-4T also issued under 26 U.S.C. 411(d)(6). * * *

Par. 2. Section 1.411(d)-4 is amended by:

1. Revising Q&A-2(d)(2)(ii).
2. Removing the last sentence of Q&A-2(d)(3).
3. Adding Q&A-11.

The additions and revisions read as follows:

§1.411(d)-4 Section 411(d)(6) protected benefits.

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Q-2: * * *

A-2: * * *

(d) * * *

(2) * * *

(ii) *Employer becomes substantially employee-owned or is an S corporation.*

The employer eliminates, or retains the discretion to eliminate, with respect to all participants, optional forms of benefit by substituting cash distributions for distributions in the form of employer stock with respect to benefits subject to section 409(h) in the circumstances described in paragraph (d)(1)(ii)(A) or (B) of this Q&A-2, but only if the employer otherwise meets the requirements of section 409(h)(2)—

(A) The employer becomes substantially employee-owned; or

(B) For taxable years of the employer beginning after December 31, 1997, the employer is an S corporation as defined in section 1361.

* * * * *

Q-11: To what extent may a plan amendment that is made pursuant to the Taxpayer Relief Act of 1997 (TRA '97) (Public Law 105-34, 111 Stat. 788), reduce or eliminate section 411(d)(6) protected benefits?

A-11: A plan amendment does not violate the requirements of section 411(d)(6) merely because the plan amendment reduces or eliminates section 411(d)(6) protected benefits as of the effective date of the plan amendment, provided that—

(a) The plan amendment is made pursuant to an amendment made by title XV, or subtitle H of title X, of TRA '97; and

(b) The plan amendment is adopted no later than the last day of any remedial amendment period that applies to the plan pursuant to §§1.401(b)-1 and 1.401(b)-1T for changes under TRA '97.

§1.411(d)-4T [Removed]

Par. 3. Section 1.411(d)-4T is removed.

Robert E. Wenzel,
*Deputy Commissioner of
Internal Revenue.*

Approved January 7, 1999.

Donald C. Lubick,
*Assistant Secretary of
the Treasury.*

(Filed by the Office of the Federal Register on January 7, 1999, 8:45 a.m., and published in the issue of the Federal Register for January 8, 1999, 64 F.R. 1125)

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of February 1999. See Rev. Rul. 99-8, page 10.

Section 708.—Continuation of Partnership

26 CFR 1.708-1: *Continuation of partnership.*
(Also sections 731, 732, 735, 741, 751, 1012; 1.741-1; 301.7701-2, 301.7701-3.)

Partnership to disregarded entity.

This ruling describes the federal income tax consequences if one person purchases all of the ownership interests in a domestic limited liability company (LLC) that is classified as a partnership under section 301.7701-3 of the Procedure and Administration Regulations, causing the LLC's status as a partnership to terminate under section 708(b)(1)(A) of the Code.

Rev. Rul. 99-6

ISSUE

What are the federal income tax consequences if one person purchases all of the ownership interests in a domestic limited liability company (LLC) that is classified as a partnership under § 301.7701-3 of the Procedure and Administration Regulations, causing the LLC's status as a partnership to terminate under § 708(b)(1)(A) of the Internal Revenue Code?

FACTS

In each of the following situations, an LLC is formed and operates in a state which permits an LLC to have a single owner. Each LLC is classified as a partnership under § 301.7701-3. Neither of the LLCs holds any unrealized receivables or substantially appreciated inventory for purposes of § 751(b). For the sake of simplicity, it is assumed that neither LLC is liable for any indebtedness, nor are the assets of the LLCs subject to any indebtedness.

Situation 1. A and B are equal partners in AB, an LLC. A sells A's entire interest in AB to B for \$10,000. After the sale, the business is continued by the LLC, which is owned solely by B.

Situation 2. C and D are equal partners in CD, an LLC. C and D sell their entire interests in CD to E, an unrelated person, in exchange for \$10,000 each. After the sale, the business is continued by the LLC, which is owned solely by E.

After the sale, in both situations, no entity classification election is made under § 301.7701-3(c) to treat the LLC as an association for federal tax purposes.

LAW

Section 708(b)(1)(A) and § 1.708-1(b)(1) of the Income Tax Regulations provide that a partnership shall terminate when the operations of the partnership are discontinued and 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.

Section 731(a)(1) provides that, in the case of a distribution by a partnership to a partner, gain is not recognized to the partner except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

Section 731(a)(2) provides that, in the case of a distribution by a partnership in liquidation of a partner's interest in a partnership where no property other than money, unrealized receivables (as defined in § 751(c)), and inventory (as defined in § 751(d)(2)) is distributed to the partner, loss is recognized to the extent of the excess of the adjusted basis of the partner's interest in the partnership over the sum of (A) any money distributed, and (B) the basis to the distributee, as determined under § 732, of any unrealized receivables and inventory.

Section 732(b) provides 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 the partner's interest in the partnership, reduced by any money distributed in the same transaction.

Section 735(b) provides that, in determining the period for which a partner has

held property received in a distribution from a partnership (other than for purposes of § 735(a)(2)), there shall be included the holding period of the partnership, as determined under § 1223, with respect to the property.

Section 741 provides that gain or loss resulting from the sale or exchange of an interest in a partnership shall be recognized by the transferor partner, and that the gain or loss shall be considered as gain or loss from a capital asset, except as provided in § 751 (relating to unrealized receivables and inventory items).

Section 1.741-1(b) provides that § 741 applies to the transferor partner in a two-person partnership when one partner sells a partnership interest to the other partner, and to all the members of a partnership when they sell their interests to one or more persons outside the partnership.

Section 301.7701-2(c)(1) provides that, for federal tax purposes, the term "partnership" means a business entity (as the term is defined in § 301.7701-2(a)) that is not a corporation and that has at least two members.

In *Edwin E. McCauslen v. Commissioner*, 45 T.C. 588 (1966), one partner in an equal, two-person partnership died, and his partnership interest was purchased from his estate by the remaining partner. The purchase caused a termination of the partnership under § 708(b)(1)(A). The Tax Court held that the surviving partner did not purchase the deceased partner's interest in the partnership, but that the surviving partner purchased the partnership assets attributable to the interest. As a result, the surviving partner was not permitted to succeed to the partnership's holding period with respect to these assets.

Rev. Rul. 67-65, 1967-1 C.B. 168, also considered the purchase of a deceased partner's interest by the other partner in a two-person partnership. The Service ruled that, for the purpose of determining the purchaser's holding period in the assets attributable to the deceased partner's interest, the purchaser should treat the transaction as a purchase of the assets attributable to the interest. Accordingly, the purchaser was not permitted to succeed to the partnership's holding period with respect to these assets. See also Rev. Rul. 55-68, 1955-1 C.B. 372.

Situation 1. The AB partnership terminates under § 708(b)(1)(A) when B purchases A's entire interest in AB. Accordingly, A must treat the transaction as the sale of a partnership interest. Reg. § 1.741-1(b). A must report gain or loss, if any, resulting from the sale of A's partnership interest in accordance with § 741.

Under the analysis of *McCauslen* and Rev. Rul. 67-65, for purposes of determining the tax treatment of B, the AB partnership is deemed to make a liquidating distribution of all of its assets to A and B, and following this distribution, B is treated as acquiring the assets deemed to have been distributed to A in liquidation of A's partnership interest.

B's basis in the assets attributable to A's one-half interest in the partnership is \$10,000, the purchase price for A's partnership interest. Section 1012. Section 735(b) does not apply with respect to the assets B is deemed to have purchased from A. Therefore, B's holding period for these assets begins on the day immediately following the date of the sale. See Rev. Rul. 66-7, 1966-1 C.B. 188, which provides that the holding period of an asset is computed by excluding the date on which the asset is acquired.

Upon the termination of AB, B is considered to receive a distribution of those assets attributable to B's former interest in AB. B must recognize gain or loss, if any, on the deemed distribution of the assets to the extent required by § 731(a). B's basis in the assets received in the deemed liquidation of B's partnership interest is determined under § 732(b). Under § 735(b), B's holding period for the assets attributable to B's one-half interest in AB includes the partnership's holding period for such assets (except for purposes of § 735(a)(2)).

Situation 2. The CD partnership terminates under § 708(b)(1)(A) when E purchases the entire interests of C and D in CD. C and D must report gain or loss, if any, resulting from the sale of their partnership interests in accordance with § 741.

For purposes of classifying the acquisition by E, the CD partnership is deemed to make a liquidating distribution of its assets to C and D. Immediately following

this distribution, *E* is deemed to acquire, by purchase, all of the former partnership's assets. Compare Rev. Rul. 84-111, 1984-2 C.B. 88 (Situation 3), which determines the tax consequences to a corporate transferee of all interests in a partnership in a manner consistent with *McCauslen*, and holds that the transferee's basis in the assets received equals the basis of the partnership interests, allocated among the assets in accordance with § 732(c).

E's basis in the assets is \$20,000 under § 1012. *E*'s holding period for the assets begins on the day immediately following the date of sale.

DRAFTING INFORMATION

The principal author of this revenue ruling is Matthew Lay of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Mr. Lay at (202) 622-3050 (not a toll-free call).

Section 721.—Nonrecognition of Gain or Loss on Contribution

26 CFR 1.721-1: Nonrecognition of gain or loss on contribution.
(Also sections 722, 723, 1001, 1012, 1223, 7701; 1.1223-1, 301.7701-3.)

Disregarded entity to partnership. This ruling describes the federal income tax consequences when a single member limited liability company that is disregarded as an entity separate from its owner under section 301.7701-3 of the Procedure and Administration Regulations becomes an entity with more than one owner that is classified as a partnership for federal tax purposes.

Rev. Rul. 99-5

ISSUE

What are the federal income tax consequences when a single member domestic limited liability company (LLC) that is disregarded for federal tax purposes as an entity separate from its owner under § 301.7701-3 of the Procedure and Administration Regulations becomes an entity with more than one owner that is classified as a partnership for federal tax purposes?

FACTS

In each of the following two situations, an LLC is formed and operates in a state which permits an LLC to have a single owner. Each LLC has a single owner, *A*, and is disregarded as an entity separate from its owner for federal tax purposes under § 301.7701-3. In both situations, the LLC would not be treated as an investment company (within the meaning of § 351) if it were incorporated. All of the assets held by each LLC are capital assets or property described in § 1231. For the sake of simplicity, it is assumed that neither LLC is liable for any indebtedness, nor are the assets of the LLCs subject to any indebtedness.

Situation 1. *B*, who is not related to *A*, purchases 50% of *A*'s ownership interest in the LLC for \$5,000. *A* does not contribute any portion of the \$5,000 to the LLC. *A* and *B* continue to operate the business of the LLC as co-owners of the LLC.

Situation 2. *B*, who is not related to *A*, contributes \$10,000 to the LLC in exchange for a 50% ownership interest in the LLC. The LLC uses all of the contributed cash in its business. *A* and *B* continue to operate the business of the LLC as co-owners of the LLC.

After the sale, in both situations, no entity classification election is made under § 301.7701-3(c) to treat the LLC as an association for federal tax purposes.

LAW AND ANALYSIS

Section 721(a) generally 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 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of the money and the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 723 provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of the property to the contributing partner at the

time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at such time.

Section 1001(a) provides that the gain or loss from the sale or other disposition of property shall be the difference between the amount realized therefrom and the adjusted basis provided in § 1011.

Section 1223(1) provides that, in determining the holding period of a taxpayer who receives property in an exchange, there shall be included the period for which the taxpayer held the property exchanged if the property has the same basis in whole or in part in the taxpayer's hands as the property exchanged, and the property exchanged at the time of the exchange was a capital asset or property described in § 1231.

Section 1223(2) provides that, regardless of how a property is acquired, in determining the holding period of a taxpayer who holds the property, there shall be included the period for which such property was held by any other person if the property has the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person.

HOLDING(S)

Situation 1. In this situation, the LLC, which, for federal tax purposes, is disregarded as an entity separate from its owner, is converted to a partnership when the new member, *B*, purchases an interest in the disregarded entity from the owner, *A*. *B*'s purchase of 50% of *A*'s ownership interest in the LLC is treated as the purchase of a 50% interest in each of the LLC's assets, which are treated as held directly by *A* for federal tax purposes. Immediately thereafter, *A* and *B* are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

Under § 1001, *A* recognizes gain or loss from the deemed sale of the 50% interest in each asset of the LLC to *B*.

Under § 721(a), no gain or loss is recognized by *A* or *B* as a result of the conversion of the disregarded entity to a partnership.

Under § 722, *B*'s basis in the partnership interest is equal to \$5,000, the amount paid by *B* to *A* for the assets