Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Number: 1362.02-03, 1375.00-00

Number: **199937034**
Release Date: 9/17/1999

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:P&SI:2 - PLR-103884-99
Date:
June 22, 1999

X =

A =

B =

C =

a =

b =

c =

d =

D1 =

Year 1 =

LP =

GP =

Dear :

This letter responds to a letter dated January 31, 1999, and subsequent correspondence submitted by you on behalf of X as X's authorized representative, requesting rulings under §§ 1362 and 1375 of the Internal Revenue Code.

The information submitted states that X was incorporated as a C corporation on D1. X elected to be an S corporation

effective for its Year 1 taxable year. On the effective date of its S corporation election, X had accumulated C corporation earnings and profits of approximately $a. A, X's Chief Financial Officer, represents that no C corporation earnings and profits have been distributed since X became an S corporation.

X is the owner of a b% limited partner interest in LP. The owner of the c% general partner interest in LP is B, an S corporation, owned by certain shareholders of X. LP is the owner of a d% general partner interest in GP, a general partnership. The other owner of GP is C, an unrelated third party. All partnership allocations of items of income, gain, loss, deduction and credit are made in accordance with the percentage interests of the partners and § 704 and the regulations thereunder.

Pursuant to the agreement between LP and C establishing GP, LP has an option to put its entire partnership interest in GP to C, and C has an option to purchase LP's entire partnership interest in GP. At any time after the third anniversary of the formation of GP, LP may activate the option. Once activated, either LP or C may exercise the option at any time after the second anniversary of the activation. In addition, in the event of a change in control of certain of C's affiliates or the formation of certain strategic alliances by C's affiliates, LP may put its entire partnership interest in GP to an affiliate of C.

X requests that, for the purposes of applying the passive investment income limitation of § 1362(d)(3) and the tax imposed on excess net passive income in § 1375(a), X's distributive share of LP's gain from any disposition of its general partner interest in GP should not be treated as passive investment income, except to the extent of its distributive share of the amount that LP would have received as a distributive share of gain from the sale of stock or securities held by GP if all the stock and securities of GP had been sold at fair market value at the time LP disposed of its general partner interest.

Section 1375(a) provides that, if for a taxable year an S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts more than 25% of which are passive investment income, then there is imposed a tax on the income of such corporation for such taxable year.

Section 1362(d)(3)(C)(i) provides that, except as otherwise provided, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(4)(ii)(B)(4)(i) of the Income Tax Regulations provides that, except as otherwise provided, if an S corporation disposes of a general partner interest, the gain on the disposition is treated as gain from the sale of stock or securities to the extent of the amount the S corporation would have received as a distributive share of gain from the sale of stock or securities held by the partnership if all the stock and securities held by the partnership had been sold by the partnership at fair market value at the time the S corporation disposes of the general partner interest. In applying this rule, the S corporation's distributive share of gain from the sale of stock or securities held by the partnership is not reduced to reflect any loss that would be recognized from the sale of stock or securities held by the partnership. In the case of tiered partnerships, the rules of § 1.1362-2(c)(4)(ii)(B)(4)(i) apply by looking through each tier.

Based on the facts and representations submitted, we conclude that X's distributive share of LP's gain from any disposition of its general partner interest in GP will not be treated as passive investment income, except to the extent of its distributive share of the amount that LP would have received as a distributive share of gain from the sale of stock or securities held by GP if all the stock and securities of GP had been sold at fair market value at the time LP disposed of its general partner interest.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed or implied on whether any transaction described above constitutes a transaction described in § 707.

A copy of this letter should be attached to the first federal tax return that reflects this transaction. A copy is enclosed for that purpose.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X and to X's other authorized representative.

Sincerely yours,

J. THOMAS HINES
Senior Technician Reviewer
Branch 2
Office of the Assistant
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
Copy of this letter
Copy for § 6110 purposes