

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:
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Telephone Number:

Refer Reply To:
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PLR-126739-16

Date:
February 22, 2017

X =

Y =

Date =

State =

Dear

This letter responds to a letter dated August 23, 2016, submitted on behalf of X, requesting a ruling under section 1374 of the Internal Revenue Code (Code).

FACTS

The information submitted states that X is a State corporation that elected to be a subchapter S corporation effective Date. X owns a controlling interest in Y, a State limited liability company that is classified as a partnership for Federal income tax purposes. Y has both preferred and common membership interests outstanding. X currently owns all of the preferred interests while other members own the common interests.

Y proposes to undertake a recapitalization under which X would convert its preferred interests in Y to common interests. X represents that (1) the fair market value of the preferred interests will equal the fair market value of the common interests to be received in the conversion, (2) there will not be a shift in the ownership of the capital of Y associated with the conversion, and (3) the recapitalization will not result in a deemed

distribution in excess of basis as a result of any change in any member's share of Y's liabilities.

X requests a ruling that no gain or loss will be recognized by X as a result of the conversion of its interest in Y during the recognition period under section 1374(d)(7) and X will therefore not be subject to tax under section 1374(a).

LAW AND ANALYSIS

Section 1374(a) provides that if for any taxable year beginning in the recognition period an S corporation has a net recognized built-in gain, there is imposed a tax (computed under section 1374(b)) on the income of such corporation for such taxable year.

Section 1374(d)(2) provides that the term "net recognized built-in gain" means, with respect to any taxable year in the recognition period, the lesser of (i) the amount which would be the taxable income of the S corporation for such taxable year if only recognized built-in gains and recognized built-in losses were taken into account, or (ii) such corporation's taxable income for such taxable year (determined as provided in section 1375(b)(1)(B)).

Section 1374(d)(3) provides that the term "recognized built-in gain" means any gain recognized during the recognition period on the disposition of any asset except to the extent that the S corporation establishes that (A) such asset was not held by the S corporation as of the beginning of the 1st taxable year for which it was an S corporation, or (B) such gain exceeds the excess (if any) of (i) the fair market value of such asset as of the beginning of such 1st taxable year, over (ii) the adjusted basis of the asset as of such time.

Section 1.1374-4(a)(1) of the Income Tax Regulations provides that section 1374(d)(3) applies to any gain or loss recognized during the recognition period in a transaction treated as a sale or exchange for Federal income tax purposes.

Section 1374(d)(7) provides that the term "recognition period" means the 5-year period beginning with the first day of the first taxable year for which the corporation was an S corporation.

CONCLUSION

Based solely on the information submitted and representations made, we conclude that no gain or loss will be recognized by X as a result of the conversion of its interest in Y. Accordingly, no entity level tax under section 1374 will be imposed on X as a result of the conversion.

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Except as specifically ruled above, we express or imply no opinion concerning the Federal tax consequences of the transaction described above under any other provision of the Code.

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

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Holly Porter
Chief, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes