

INTERNAL REVENUE SERVICE

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September 15, 2000

P1 =

A =

B =

C =

D =

State W =

Dear :

This is in reply to a letter dated December 28, 1999, and subsequent correspondence, submitted by your authorized representative requesting certain rulings regarding the formation of P1.

P1 is a State W limited liability company. The initial members of P1 are A, B, C, and D. Initially A, B, C, and D will each contribute cash to P1. Each will receive a twenty-five percent interest in P1. Subsequent to the receipt of this letter A proposes to contribute certain real property to P1 in exchange for additional units in P1. At the time of the contribution of the real property to P1 it will be subject to a mortgage. Following the contribution of the real property to P1, P1 will execute a debt assumption agreement making it primarily liable on the mortgage. Coinciding with P1's execution of the assumption agreement A proposes to execute a continuing guarantee, thereby continuing A's individual liability on the mortgage. A's guarantee would be a guarantee of payment, so the creditor could proceed directly against A without first attempting to collect from P1. A also would waive any subrogation or similar rights to

repayment. A also will agree to indemnify P1 if it were required to satisfy the liability. A represents that no other person would guarantee or otherwise bear the economic risk of loss with respect to the liability. A's authorized representative represented that under State W law, a member of a State W limited liability company is not liable for the acts, debts, or obligations of the limited liability company.

Section 721(a) of the Internal Revenue Code 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. However, if the property contributed to the partnership is encumbered and the encumbrance becomes a liability of the partnership, then, under section 752(b) the contributing partner is deemed to receive a distribution of money from the partnership in an amount equal to the reduction in the partner's share of the liability.

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership is 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 section 721(b) by the contributing partner at the time of the contribution.

Section 731(a)(1) provides that, in the case of a distribution by a partnership to a partner, gain is generally 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. Under § 731(b), no gain or loss is recognized by a partnership on a distribution to a partner of property, including money.

Section 752(a) provides that any increase in a partner's share of liabilities of a partnership, or any increase in a partner's individual liabilities by reason of the assumption by the partner of partnership liabilities is considered a contribution of money by the partner to the partnership. Similarly, under § 752(b), any decrease in a partner's share of liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of the individual liabilities is considered a distribution of money to the partner by the partnership.

Section 1.752-1(a)(1) the Income Tax Regulations provides that a partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss for that liability under § 1.752-2.

Section 1.752-2(a) provides that a partner's share of a recourse partnership liability equals the portion of that liability, if any, for which the partner or related person bears the economic risk of loss. The determination of the extent to which a partner bears the economic risk of loss for a partnership liability is made under the rules in paragraphs (b) through (j) of § 1.752-2.

Section 1.752-2(b)(1) provides that except as otherwise provided in § 1.752-2(b), a partner bears the economic risk of loss for a partnership liability to the extent the partner or related person would be obligated to make a payment to any person (or a contribution to the partnership) because that liability becomes due and payable and the partner or related person would not be entitled to reimbursement from another partner or person that is a related person to another partner.

Section 1.752-2(b)(3) provides that the determination of the extent to which a partner or related person has an obligation to make a payment under § 1.752(b)(1) is based on the facts and circumstances at the time of the determination. All statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying § 1.752-2(b), including contractual obligations outside the partnership agreement such as guarantees, indemnifications, reimbursement agreements, and other obligations running directly to creditors or to other partners, or to the partnership.

Section 1.752-2(b)(6) provides that for purposes of determining the extent to which a partner or related person has a payment obligation and the economic risk of loss, it is assumed that all partners and related persons who have obligations to make payments actually perform those obligations, irrespective of their actual net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation.

Based on the information provided and the representations made we conclude that the liability on the property contributed to P1 is a recourse liability for purposes of § 1.752-1(a)(1) and that liability will be allocated to A pursuant to § 1.752-2(a).

Accordingly, the contribution of the debt-encumbered property to P1 in exchange for units in P1 will not result in the recognition of gain at the time of the contribution. Furthermore, provided that A continues to bear the economic risk of loss with respect to the liability, subsequent gifts of interests in P1 will not result in the recognition of income at the time of the gift.

Except as specifically ruled upon above, we express no opinion on the federal tax consequences of the transactions described above under any other provisions of the Code.

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

Pursuant to the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

J. THOMAS HINES
Acting Branch Chief, Branch 2
Office of the Associate
Chief Counsel
(Passthroughs and
Special Industries)

Enclosures: 2
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