

Part I

Section 708.--Continuation of a Partnership

26 CFR 1.708-1: Continuation of a partnership

(Also: §§ 7701, 301.7701-1, 301.7701-2 301.7701-3)

Rev. Rul. 2004-59

ISSUE

If an unincorporated state law entity that is classified as a partnership for federal tax purposes (partnership) converts to a state law corporation under a state statute that does not require an actual transfer of the unincorporated entity's assets or interests (state law formless conversion statute), how is the conversion treated for federal tax purposes?

FACTS

On January 1, 2003, A is organized in State as an unincorporated entity that is classified as a partnership for federal tax purposes. A elects to convert under a state law formless conversion statute into a state law corporation, effective January 1, 2004. As a result of the conversion, A is classified as a corporation for federal tax purposes.

## LAW AND ANALYSIS

Section 7701(a)(2) of the Internal Revenue Code provides that the term partnership includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation.

Section 7701(a)(3) provides that the term corporation includes associations, joint-stock companies, and insurance companies.

Section 301.7701-2(b)(1) defines the term corporation to include a business entity organized under a federal or state statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic.

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8) (an eligible entity), can elect its classification for federal tax purposes.

Section 301.7701-3(g)(1)(i) provides that, if an eligible entity classified as a partnership elects under § 301.7701-3(c)(1)(i) to be classified as an association, the following is deemed to occur: the partnership contributes all its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter, the partnership liquidates, distributing the stock of the association to its partners.

Rev. Rul. 84-111, 1984-2 C.B. 88, describes the tax consequences when steps are taken as parts of a plan to transfer partnership operations to a corporation organized for valid business reasons. For each of three methods of incorporating a partnership, Rev. Rul. 84-111 describes the differences in the basis and holding periods of the various assets received by the corporation and the basis and holding periods of the stock received by the former partners provided the steps described are actually undertaken and the underlying assumptions and purposes for the conclusions in the revenue ruling are applicable. If the partnership converts into a corporation in accordance with a state law formless conversion statute, however, Rev. Rul. 84-111 does not apply.

For federal tax purposes, a partnership that converts to a corporation under a state law formless conversion statute will be treated in the same manner as one that makes an election to be treated as an association under § 301.7701-3(c)(1)(i). Therefore, when unincorporated entity A converts, under state law, to corporation A, the following steps are deemed to occur: unincorporated entity A contributes all of its assets and liabilities to corporation A in exchange for stock in corporation A, and immediately thereafter, unincorporated entity A liquidates, distributing the stock of corporation A to its partners.

#### HOLDING

If an unincorporated state law entity that is classified as a partnership for federal tax purposes converts into a state law corporation under a state law formless conversion statute, the following is deemed to occur: the partnership contributes all its

assets and liabilities to the corporation in exchange for stock in such corporation, and immediately thereafter, the partnership liquidates distributing the stock of the corporation to its partners.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Christopher L. Trump of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Christopher L. Trump on (202) 622-3080 (not a toll-free call).