Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:RFPH:[redacted]:POSTF-139416-02
[redacted]

date: OCT 2 2 2002

to: [redacted], LMSB Team Manager

from: [redacted]
Senior Attorney, LMSB Counsel Area 3

subject: **Small Partnership Exception**
[redacted]

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

This memorandum is in response to your request for advice submitted October 8, 2002.

This memorandum is being sent to Chief Counsel National Office for 10-day post-issuance review. In the event National Office wishes to make changes to this advice, the undersigned will contact you within 10 days of issuance.

ISSUE

Whether a single-owner [redacted] Limited Liability Company (LLC) is a partner for purposes of the small partnership exception of I.R.C. §6231(a)(1)(B) to the general unified partnership examination procedures of I.R.C. §§6221 et seq. (TEFRA) such that the partnership is disqualified from the small partnership exception.

CONCLUSION

The single-owner LLC is a partner for purposes of the small partnership exception. The partnership is disqualified from the small partnership exception. [redacted], (b)(7)a

FACTS

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The partnership under examination is the [redacted] ('[redacted]'). [redacted] is organized under the laws of [redacted]. [redacted] was formed to construct and manage resort property in [redacted]. The tax years under examination are tax years [redacted], [redacted], and [redacted].

[redacted] filed Form 1065 for each of the tax years under examination. According to the filed Schedules K-1, the partners of [redacted] were [redacted] ('[redacted]'), [redacted] ('[redacted]'), [redacted] ('[redacted]'), and [redacted] ('[redacted]'). [redacted] and [redacted] are organized under foreign law. [redacted] and [redacted] are LLCs organized under [redacted] law and each is owned solely by [redacted] ('[redacted]'), a United States corporation. [redacted] has made a check-the-box election to be treated as a corporation under Reg. §301.7701-3.

This memorandum assumes that [redacted], [redacted], and [redacted] are corporations within the meaning of I.R.C. §6231(a)(1)(B).[1]

[redacted] is not a corporation by default, see, Reg. §301.7701-2(b), and has not made a check-the-box election to be treated as a corporation under Reg. §301.7701-3.

ANALYSIS

A partnership is generally subject to TEFRA procedures. I.R.C. §6221(a). A 'small partnership' is not subject to TEFRA procedures. I.R.C. §6231(a)(1)(B). A small partnership is defined as follows:

> ... any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner.

I.R.C. §6231(a)(1)(B)(i).

The issue is whether [redacted] should be considered a partner of [redacted] for purposes of the small partnership exception, or whether [redacted] should be ignored, and

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[1] A [redacted] organized under the law of the Netherlands (or a country using a [redacted]-based legal system) is generally a corporation for purposes of federal income tax, subject to the 'grandfather' exceptions. See, Reg. §301.7701-2(b)(8) and (d).

[redacted] should be considered a direct partner of [redacted] for purposes of the small partnership exception. If [redacted] is the partner, [redacted] has a partner that is not an individual, corporation, or estate of a deceased partner and the small partnership exception does not apply. If [redacted] is the partner, [redacted] is a corporation and the small partnership exception applies.

[redacted]

The language and structure of I.R.C. §6231 and the regulations thereunder suggest that a single-owner entity such as [redacted] should be considered a partner under I.R.C. §6231(a)(1)(B). Reg. §301.6231(a)(1)-1T(a)(2) states that the small partnership exception does not apply "if any partner in the partnership during that taxable year is a pass-thru partner." The implication is that a 'pass-thru partner' is generally a partner under I.R.C. §6231(a)(1)(B). A pass-thru partner is defined under I.R.C. §6231(a)(9) as "a partnership, estate, trust, S-corporation, nominee, or other similar person through whom other persons hold an interest in the partnership ... ." The language "a similar person through whom other persons hold an interest in the partnership" seems to include a single-owner entity. A 'person' in general legal terminology is a broad term meaning either an individual (a natural person) or an entity created by law that has legal rights and duties (e.g. the right to sign contracts, the right to sue and be sued in court, the right to own property) similar to those of natural persons. See, Black's Law Dictionary, 1162 (7th ed. 1999). See also, the broad definition of 'person' in Reg. §301.7701-6(a). A [redacted] LLC

has such general legal rights and duties, see, [redacted], and therefore is a person separate from the owner(s). It should be noted e.g. that a nominee is a listed pass-thru person under I.R.C. §6231(a)(9) that is also generally ignored for federal income tax purposes.

Even the entity classification regulations seem to acknowledge that a single-owner entity is a legal person that as a practical matter may have certain functions for federal income tax purposes. Although the point is not directly stated, the entity classification regulations seem to distinguish between 'organizations' that fail to achieve separate legal personhood, e.g. a sole proprietorship or a subdivision of state government, and 'entities' that have separate legal personhood but will be generally 'disregarded'. See, Regs. §301.7701-1 through -3 generally. The regulations specifically state that an "entity with a single owner" may be an "entity recognized for federal tax purposes" that is a "business entity" that (because not a per se corporation) is an "eligible entity" that may elect to be treated as a corporation for federal income tax purposes. See, Regs. §301.7701-2(a) and -3. Thus the entity classification regulations recognize that a single-owner entity, although 'disregarded', nevertheless has a legal status different from that of a sole proprietorship; there is no language in the entity classification regulations that suggests that a sole proprietorship may elect to be treated as a corporation.

The Tax Court reached a consistent result in Primco Management Co. v. Commissioner, T.C. Memo. 1997-332. In Primco, the court held that an S-corporation with two shareholders that were grantor trusts (with individual beneficiaries) did not qualify for the small S-corporation exception to the TEFRA procedures (under prior law making the TEFRA procedures generally applicable to S-corporations with a small S-corporation exception similar to the small partnership exception of I.R.C. §6231(a)(1)(B)). The court rejected the argument that the grantor trusts should have been ignored as shareholders because grantor trusts are disregarded generally for federal income tax purposes.

The Tax Court also reached a consistent result in White v. Commissioner, T.C. Memo. 1991-552, aff'd, 991 F.2d 657 (10th Cir. 1993). In White, the court held that a partnership with several partnership interests held by a guardian under state law on behalf of several minors qualified for the small partnership exception to the TEFRA procedures. The court rejected the argument that the guardian was a pass-thru to defeat the small partnership exception. The court noted that under state law legal title to the partnership interests lay directly with the

minors and stated broadly that legal title generally controls with respect to who is the partner for purposes of the small partnership exception. The court stated, "In contrast [to the guardian situation], each person specifically defined as a 'pass-thru partner' in section 6231(a)(9) would hold legal title to the partnership interest. We believe this distinction is determinative ... ." In this case, [redacted] holds legal title to the partnership interest in [redacted], not [redacted].

Also, in several non-precedential administrative decisions, the Service has ruled that a single-owner entity must be respected as an existing legal person separate from the owner for various federal income tax purposes. See, e.g., CCA 200235023 (June 28, 2002) (assets of single-owner LLC may not be seized in collection of owner-taxpayer's federal income tax liability); CCA 199930013 (April 18, 1999) (same result, with specific discussion of disregarded entity issue); FSA 200052003 (September 1, 2000) (single-owner LLC successor to corporate parent of consolidated group may extend the statute of limitations with respect to the consolidated return). But see, e.g., PLR 200131014 (May 2, 2001) (immediate transfer of replacement property received in 'like kind' exchange under I.R.C. §1031 to single-owner LLC does not defeat necessary ownership continuity); PLR 9745017 (August 8, 1997) (single-owner LLC ignored as S-corporation shareholder to allow S-corporation status).

[redacted], (b)(7)a

Please contact the undersigned with any questions.

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