ALSTON & BIRD

WWW.ALSTON.COM

Federal Tax ADVISORY ▪

JANURARY 4, 2016

Investment Company Rules

Sections 351 and 362 contain investment company rules that have nothing to do with mutual funds. They define certain corporations as investment companies in counterintuitive ways and then deny the usual nonrecognition treatment of Sections 351 and 368 and the other sections governing reorganizations, when investment companies are involved. Of course these limits are of great importance, but they are easy to overlook.

For about the last year and a half, the IRS and Treasury have been working on the definition of investment companies as part of the 2014–2015 and 2015–2016 Priority Guidance Plans. The first evidence of some progress was released in November in LTR 201547003. It is a very limited ruling that illustrates how the statutes are too strict, and the existing regulations make some attempt to relieve the force of the statute, but not nearly enough.

The ruling actually concerns a contribution to a partnership. Section 721(b) provides that the normal nonrecognition rule for contributions of property to a partnership does not apply if the partnership would be an investment company under Section 351(e).

Facts

Two corporations merged. One was a new corporation and another was the general manager of a master limited partnership #1, which is a publicly traded entity not taxed as a corporation. The assets received by the corporation evidently were mostly the general partner's interest in the partnership #1. Immediately after the merger, the corporation contributed its general partner interests to X, another publicly traded partnership that owned interests in other publicly traded partnerships, #2, #3 and #4. The issue was whether X was an investment company.

The problem was that interests in "a publicly traded partnership (as defined in section 7704(b))" owned by X must be treated as cash in determining whether X in a Section 721 exchange is an investment company under Section 351(e). That matters because putting appreciated property into a cash box can be treated as a contribution to an investment company, which is a taxable exchange.

The 1996 vintage regulation provides a lookthrough rule for subsidiary corporations, but not subsidiary partnerships. So X owned some interests in three publicly traded partnerships that were treated as cash or securities and that necessarily made X an investment company. X did not own any subsidiary corporations that it could look through.

Ruling

The IRS ruled that if X owned more than half of the value of one of the three other publicly traded limited partnerships in which it owned interests, it could look through to the assets of that partnership for purposes of determining whether the corporation was an investment company. Evidently it did own that much of one and evidently a lookthrough would produce noncash assets that could help X escape the investment company label. It is curious that the fact that X itself is a publicly traded partnership does not make it a per se investment company, but Reg. Section 1.351-1(c) could because X's assets are mostly marketable securities.

This ruling expands the regulation, which predates the current statute, to apply the lookthrough to a partnership interest. In a way, that is not usual because some adaption must occur to make Section 351(e) work for partnerships. But the issue here was not that the asset transferee was a partnership but that the assets of that partnership were publicly traded partnership interests, which can occur when the potential investment company is a corporation too.

LTR 200211017 is an earlier ruling that may have contained the same interpretation.

Conclusion

One of the confusions in this area and one of the reasons for the regulation project is that the definitions of investment companies in Section 351 and Section 368 are not the same. We can hope that the regulation project goes beyond expanding lookthrough rules and somehow coordinates the two rules, making them less of a trap for the unwary.

For additional information, call Jack Cummings at 919.862.2302.

If you would like to receive future *Federal Tax Advisories* electronically, please forward your contact information to **FederalTax.Advisory@alston.com.** Be sure to put "**subscribe**" in the subject line.

Click **here** for Alston & Bird's Tax Blog.

If you have any questions or would like additional information, please contact your Alston & Bird attorney or any of the following:

Federal Tax Group

Sam K. Kaywood, Jr.
Co-Chair
404.881.7481
sam.kaywood@alston.com

Edward Tanenbaum
Co-Chair
212.210.9425
edward.tanenbaum@alston.com

George Abney
404.881.7980
george.abney@alston.com

John F. Baron
704.444.1434
john.baron@alston.com

Henry J. Birnkrant
202.239.3319
henry.birnkrant@alston.com

James E. Croker, Jr.
202.239.3309
jim.croker@alston.com

Jasper L. Cummings, Jr.
919.862.2302
jack.cummings@alston.com

Scott Harty
404.881.7867
scott.harty@alston.com

Brian D. Harvel
404.881.4491
brian.harvel@alston.com

L. Andrew Immerman
404.881.7532
andy.immerman@alston.com

Stefanie E. Kavanagh
202.239.3914
stefanie.kavanagh@alston.com

Brian E. Lebowitz
202.239.3394
brian.lebowitz@alston.com

Clay A. Littlefield
704.444.1440
clay.littlefield@alston.com

Ashley B. Menser
919.862.2209
ashley.menser@alston.com

Matthew Moseley
202.239.3828
matthew.moseley@alston.com

Danny Reach
704.444.1272
danny.reach@alston.com

Heather Ripley
212.210.9549
heather.ripley@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

ATLANTA: One Atlantic Center ▪ 1201 West Peachtree Street ▪ Atlanta, Georgia, USA, 30309-3424 ▪ 404.881.7000 ▪ Fax: 404.881.7777
BEIJING: Hanwei Plaza West Wing ▪ Suite 21B2 ▪ No. 7 Guanghua Road ▪ Chaoyang District ▪ Beijing, 100004 CN
BRUSSELS: Level 20 Bastion Tower ▪ Place du Champ de Mars ▪ B-1050 Brussels, BE ▪ +32 2 550 3700 ▪ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ▪ 101 South Tryon Street ▪ Suite 4000 ▪ Charlotte, North Carolina, USA, 28280-4000 ▪ 704.444.1000 ▪ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ▪ 18th Floor ▪ Dallas, Texas, USA, 75201 ▪ 214.922.3400 ▪ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ▪ 16th Floor ▪ Los Angeles, California, USA, 90071-3004 ▪ 213.576.1000 ▪ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ▪ 15th Floor ▪ New York, New York, USA, 10016-1387 ▪ 212.210.9400 ▪ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ▪ Suite 400 ▪ Durham, North Carolina, USA, 27703-85802 ▪ 919.862.2200 ▪ Fax: 919.862.2260
SILICON VALLEY: 1950 University Avenue ▪ 5th Floor ▪ East Palo Alto, California, USA, 94303-2282 ▪ 650.838.2000 ▪ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ▪ 950 F Street, NW ▪ Washington, DC, USA, 20004-1404 ▪ 202.239.3300 ▪ Fax: 202.239.3333