

**In the Matter of "the Petitioner"**

**For a Declaratory Ruling**

**Document #7458, Effective 2/26/01**

**DETERMINATION REQUESTED BY THE PETITIONER**

Pursuant to RSA 541-A:1, IV, 541-A:2, I(d) and Rev 209.01 et seq., ABC Company Inc., petitioned the Department of Revenue Administration with respect to the New Hampshire tax treatment of a proposed merger of DEF LLC a single member limited liability company (subsequently referred to as LLC) into its corporate member ABC.

Under a proposed transaction, the assets, liabilities and equity of DEF would be merged into ABC. The business operations of DEF would then be conducted by ABC. The LLC would cease to exist at the time of the merger and ABC would be the surviving entity.

Petitioner requests a response to the following questions:

Does the transfer of assets, including intangibles, get treated for business profits tax purposes as the sale, exchange or other disposition for fair market value resulting in the recognition of gain or loss; or

Does the merger of the single member LLC into its corporate member result in a tax-free transaction for business profits tax purposes?

**FACTS PRESENTED BY THE PETITIONERS**

The petitioners made the following representations of relevant facts:

1. ABC is a New Hampshire corporation treated as an "S" corporation for federal tax purposes.
2. ABC is incorporated.
3. DEF is a single member LLC.
4. ABC is the sole "member" of DEF.
5. DEF, as a single member LLC, is not required to file a separate federal income tax return because its activities are reported within the federal income tax return of the member.
6. The business activities of ABC and DEF are conducted solely within the geographical boundaries of the state of NH.
7. All of the assets and liabilities of DEF will be assigned to and assumed by ABC as of the end of operations on a date to be specified,

8. Subsequent to the transfer, DEF would no longer exist as a legal entity through a formal dissolution under state law to be effective at the end of operations on the same date as the assignment of assets and assumption of liabilities by ABC.

9. The merger will not involve any boot to the shareholder/member.

10. The basis of the assets in the hands of the transferee will not be adjusted as a result of the transfer.

## **REVISED STATUTES ANNOTATED [RSA] AT ISSUE**

77-A Business Profits Tax

77-A: 1,I Business Organization

77-A: 1,III Gross Business Profits

77-A: 1,XX United States Internal Revenue Code

77-A: 4,XIV Sale or Exchange of Interest

304-C Limited Liability Companies

304-C: 18 Merger

## **RULES AT ISSUE**

N.H. Code of Administrative Rules

Rev 300 Business Profits Tax

302.01 Business Organizations Organized As "S" Corporations For Federal Income Tax Purposes

302.04 Business Organizations Whose Income Or Expenses Are Federally Reportable By The Owners

307.01 Uniform Filing Information

307.02 Corporate Returns And Declarations

## **OTHER LAWS OR RULES**

U S Internal Revenue Code

IRC § 332

IRC § 334

IRC § 337

IRC § 731

IRC § 732

IRC § 751

### **PETITIONER'S REPRESENTATIONS**

To the best of petitioner's knowledge, the issues that are the subject of this petition:

1. Are not under examination by the department;
2. Have not been examined by the department;
3. Are not under consideration by the department in connection with a return of a prior period; and
4. Are not pending in litigation.

### **PETITIONER'S POSITION**

ABC organized a single member LLC to operate in facilities which house ABC's business. ABC intends to actually merge DEF and DEF would cease to exist as a legal entity. ABC will not receive any "boot" from this transaction nor will there be any basis adjustment in the assets received from DEF.

DEF is a single member LLC and as such is ignored for federal income tax purposes. DEF is not required to file a federal income tax return and its income and deductions are included in the federal return of ABC. DEF has not elected to be treated as a corporate entity for federal income tax purposes.

ABC believes that there is no federal tax consequence to the proposed transaction and as such there would not be a state tax consequence.

### **FINDINGS**

The New Hampshire Supreme Court has stated that the starting point for interpreting the business profits tax is the language of the statute itself. [Bradley Real Estate Trust v. Taylor (1986) 128 N.H. 441, 515 A2d 1212] Accordingly, it is appropriate to turn to the provisions of the statute and rules to consider their affect on the facts provided by the petitioner.

Since the New Hampshire statute incorporates the U S Internal Revenue Code (subsequently referred to as IRC) for the determination of gross business profits, it is also necessary to examine the applicability of federal income tax provisions. There exists some differences in the application of the federal provisions to New Hampshire law because the business profits tax is applied at the entity level whereas federal tax law does allow for the tax to be imposed on the true owner rather than on the entity.

The statutory language defining a business organization [ RSA 77-A:1, I ] provides in part:

"A partnership, limited liability company, estate, trust, except grantor trusts pursuant to section 671 of the United States Internal Revenue Code, "S" corporations, real estate investment trust, or any other such entity, other than a qualified investment company as defined in RSA 77-A:1, XXI that is not taxable under RSA 77-A:2-c, whose net income is reportable by the true owners either directly or indirectly shall be subject to tax at the entity level, and no part of such earnings or loss shall be included in the calculation of the gross business profits of the owners of such entity".

The language clearly requires that ABC and DEF be treated as separate business organizations for state tax purposes. Since the statute requires the separate treatment, the determination of potential taxability or non-taxability of the transaction must be determined as if the two organizations were individually subject to the federal income tax provisions.

The deemed federal tax treatment for DEF could be determined using corporate tax characteristics since the single member is an "S" corporation or it could follow non-corporate tax principles since limited liability companies have many characteristics that are similar to partnerships. There is little federal precedent for the merger and dissolution of a LLC. The commentary that exists relates to limited liability companies being treated as partnerships and does not address the relatively new category of single member limited liability companies that are ignored for federal income tax purposes.

The department provides an analysis for both approaches since the end result appears to be the same. The transaction under both will generally be a tax-free merger and the basis of the property in the hands of the transferee is the same as it was in the hands of the transferor.

The enabling statutory language, New Hampshire Revised Statutes Annotated Chapter 304-C:18, authorizes a merger unless otherwise provided in writing in the LLC agreement. The LLC agreement at issue does not prohibit such a transaction.

### **Treatment As A Corporation**

The IRC permits a tax-free exchange in a qualified "reorganization" provided that the transaction falls within one of seven categories. [IRC § 368] IRC § 368(a)(1)(A) statutory (i.e., under the controlling state statute) merger or consolidation is the oldest of, and the prototype for, the various reorganization forms. In a merger, one corporation absorbs the corporate enterprise of another, with the result that the acquiring company steps into the shoes of the disappearing corporation as to its assets and liabilities. A statutory merger of an 80 percent-owned subsidiary into its parent corporation is controlled by the subsidiary-liquidation non-recognition rules of IRC § 332.

Generally, property distributed in a complete liquidation of a corporation will be deemed to have been sold by the corporation at its fair market value and any gain or loss will be recognized by the liquidating corporation. If the distribution in complete liquidation is made by a subsidiary to a parent corporation (owning at least 80% by

value and voting power of the subsidiary), then no gain or loss on the distribution is recognized by either:

- (1) The parent corporation under IRC § 332; or
- (2) The liquidating subsidiary under IRC § 337.

The parent corporation's basis in the assets acquired from the liquidation of a subsidiary is the same as it would be in the hands of the subsidiary as provided in IRC § 334(b).

The business profits treatment in a corporate context would be governed by RSA 77-A:1, III whereby the gross business profits of the parent corporation and the subsidiary would reflect no gain or loss on the merger and subsequent liquidation of the subsidiary. Since there is no increase in the basis of the assets in the hands of the parent corporation, the provisions of RSA 77-A:4, XIV would not be applicable to the transaction.

### **Treatment As A Partnership**

The termination of an LLC entity is provided for under RSA 304-C:50 which provides in part:

"A limited liability company is dissolved and its affairs shall be wound up upon the first to occur of the following: ...

II. Unless otherwise provided in the limited liability company agreement, the vote or written consent of a majority of the members."

IRC § 731(b) provides that there is no gain or loss to be recognized by the partnership on a distribution to a partner of property including money. The member of the LLC would generally not recognize any gain or loss on the receipt of the liquidating distribution as provided in IRC § 731(a).

Gain would be recognized by the member in instances where the amount of money distributed exceeds the adjusted basis of the member's interest in the LLC. Loss would also be recognized when the adjusted basis of the member's interest in the LLC, exceeds the money distributed plus the basis to the distributee [IRC § 732] of any unrealized receivables and inventory [as defined in IRC § 751(d)]. The gain or loss in such instances is characterized as coming from the sale or exchange of the member's interest.

In instances where the gain or loss is recognized for federal income tax purposes and the member is a corporate business organization under RSA 77-A:1, the member's business profits tax return would incorporate the amount of gain or loss recognized for federal income tax purposes. [Concord Investment Corporation v. New Hampshire Tax Commission (1974) 114 NH 105, 316 A2d 192]

The basis of the distributed property [IRC § 732(b)] in the hands of the corporation would then be the member's adjusted basis in the LLC interest immediately before the distribution less the amount of any money received.

## **RULINGS**

Based on the facts as represented by the petitioners and the statutory provisions discussed above, the department makes the following rulings:

The merger of an LLC treated as a corporation into its corporate member shall be a tax-free merger for purposes of the business profits tax;

The merger of an LLC treated as a non-corporate entity into its corporate member shall be a tax-free transaction unless the amount of money received exceeds the member's adjusted basis in the LLC interest in which cases gain will be recognized under RSA 77-A:1, III; and

The merger of an LLC treated as a non-corporate entity into its corporate member shall be a tax-free transaction unless the member's adjusted basis in the interest exceeds the money distributed plus the basis to the distributee [IRC § 732] of any unrealized receivables and inventory [as defined in IRC § 751(d)] in which case loss shall be recognized under RSA 77-A:1,III.

Stanley R. Arnold, Commissioner