Dara Jaffee
Acting General Counsel
Legal Affairs
DaraJaffee@Finance.nyc.gov

345 Adams Street
3rd Floor
Brooklyn, New York 11201

+1 718 403-3671 tel
+1 718 403-3650 fax

April 15, 2014

Re: Ruling Request
New York City Unincorporated Business Tax
FLR No.: 13-4946

Dear:

This is in response to your request for a ruling dated August 5, 2013 regarding the treatment under the New York City Unincorporated Business Tax ("UBT") of the purchase of interests in a limited liability company ("LLC") doing business in New York City by a corporation ("the Purchaser"). This office received additional information on November 7 and December 12, 2013.

FACTS:

The facts as presented are as follows:

The LLC is treated as a partnership for federal tax purposes. The LLC is engaged in the business of providing IT management or technology solutions for the hospitality business, enabling companies to better manage their business by more efficiently tracking orders, payments and operations. The members of the LLC, consisting of mostly individuals, four limited liability companies and a trust, are selling their membership interests to the Purchaser. The sale is structured as a merger of a wholly owned subsidiary of the Purchaser ("Merger Sub") into the LLC. Except for an individual called "the Founder", the members of the LLC will receive cash for their interests. The "Founder" was the CEO of the LLC and founded and developed the company. The "Founder" will receive "Deferred Cash Consideration" pursuant to which he will be paid cash by Purchaser upon certain vesting events, such as remaining an employee of the Purchaser through a certain date, and restricted shares of the Purchaser's common stock. The Founder's membership interest in the LLC was not part of a separate IT management or hospitality management business. The Founder, concurrently with the execution of the merger agreement, is executing an employment offer letter with the Purchaser, and the Founder and certain other

person(s) is/are executing Non-Competition agreements. The business of the LLC will be continued.

You state in your letter of November 7, 2013 that the transaction is structured as a merger, rather than a direct purchase of the member interests, to facilitate the ease of the transaction in that it allows the LLC to sign the deal documents, rather than having to obtain signatures from every LLC member. You have represented that the Merger transaction described in the Agreement and Plan of Merger is accomplished pursuant to Title 8, Section 264 (c) of the Delaware General Corporation Law and Title 6, Section 18-209 of the Delaware Limited Liability Company Act. You have represented that for federal income tax purposes, the transaction is treated as a sale of LLC interests by the sellers (the members of the LLC) but the acquisition of assets from the LLC by the sole buyer similar to Situation 2 of Revenue Ruling 99-6. The LLC will not make an election to be treated as an association taxed as a corporation.

ISSUE:

The questions presented are as follows:

A. Does the LLC recognize gain on the sale of the membership interests by its members?

B. Will the "Founder" be required to report gain on the sale of his membership interest for UBT purposes?

CONCLUSION:

B. For purposes of the UBT, the LLC will not recognize any gain or loss on the disposition of the membership interests.

C. The "Founder" is not required to report gain on the sale of his membership interest under the UBT.

DISCUSSION:

A. No Gain or Loss to LLC.

The UBT is imposed on the unincorporated business taxable business income ("UBI") of every unincorporated business carried on within New York City. Administrative Code of the City of New York (the "Code") §11-503(a). A taxpayer's UBI is computed by reducing its unincorporated business gross income (determined under Code section 11-506) by its allowable unincorporated business deductions (determined under Code section 11-507). Code section 11-506(a) defines unincorporated gross income of an unincorporated business, in pertinent part, as follows:

> …[T]he sum of the items of income and gain of the business, of whatever kind and in whatever form paid, includible in gross income for the taxable year for federal purposes,

including income and gain from any property employed in the business, or from the liquidation of the business.

You have represented that the merger transaction was designed to accomplish a sale of the interests in LLC to the Purchaser. In support of your position you cite Treas. Reg. section 1.368-1(b) which provides in part that a sale is to be treated as a sale even though the mechanics of a reorganization have been set up. See also, Rev. Rul. 69-6, 1969-1 C.B. 104 (acquisition of stock in merger by transfer of withdrawable deposits is a sale of stock for cash), and Rev. Rul. 73-427, 1973-2 C.B. 301 (acquisition of 97.9% of stock for cash in a merger, followed by an acquisition of 2.1% for stock of acquirer, is a taxable purchase). Similarly, in this case, although the transaction is structured as a merger of Merger Sub into the LLC, applying the principle of substance over form, it should be treated as a sale of partnership interests since after the transaction the sole owner of the LLC will be the Purchaser.

This transaction would also be considered a sale under step transaction principles applicable in federal tax law. In Rev. Rul. 90-95, 1990-2 CB 67**,** Situation 1, P, a domestic corporation, formed a wholly owned domestic subsidiary corporation, *S*, for the sole purpose of acquiring all of the stock of an unrelated domestic target corporation, *T*, by means of a reverse subsidiary cash merger. Prior to the merger, *S* conducted no activities other than those required for the merger. Pursuant to the plan of merger, *S* merged into *T* with *T* surviving. The shareholders of *T* exchanged all of their *T* stock for cash from *S*. Part of the cash used to carry out the acquisition was received by *S* from P; the remaining cash was borrowed by *S*. Following the merger, *P* owned all of the outstanding *T* stock. IRS ruled that the merger resulted in a qualified stock purchase under Internal Revenue Code ("IRC") §338. Although Rev. Rul. Rev. Rul. 90-95 involved the acquisition of stock of a corporation, rather than interests in a partnership, the step transaction principles similarly apply in the case of an acquisition of partnership interests. In this case, the Purchaser will supply the cash and other consideration paid to the sellers. Accordingly, the merger transaction will be treated as an acquisition of the interests in LLC.

The treatment of a sale in partnership interests is governed by IRC §741. IRC §741 provides:

"In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items)."

However, the situation is more complicated in this case. Because the LLC will have only one owner after the merger, the LLC's business will no longer be carried on in partnership form. IRC §708(b)(1)(A) provides that a partnership is terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership. Accordingly, the merger will result in the termination of the partnership. The IRS has dealt with the treatment of a sale of partnership interests that results in a partnership termination under IRC §708(b)(1)(A) in Situation 2 of Rev. Rul. 99-6. In Situation 2, IRS ruled the partners

who sold their interests to a single buyer report the sale as a sale of partnership interests under IRC §741, notwithstanding that from the buyer's perspective, the partners are treated as having sold the partnership's assets.

Although Rev. Rul. 99-6 contains a bifurcated treatment of what is essentially one transaction, for purposes of this ruling the treatment of the LLC after the merger is not relevant. We are ruling only on whether the LLC or the Founder are subject to tax on the merger and, consequently, are only concerned with the treatment of the sellers. Under Rev. Rul. 99-6, for federal purposes, the members of the LLC are treated as selling their partnership interests. Moreover, there is no suggestion in the federal precedent that the sale should be treated as a sale by the LLC as opposed to a sale by its members. This is the critical fact in determining the UBT liability of the LLC.

The language of Code section 11-506(a) clearly indicates that gross income of the unincorporated entity is limited to that sum which is includible as gross income for federal tax purposes. Under IRC §741, the sale of the LLC members' interests does not give rise to partnership income to the LLC for federal purposes and, consequently, will not affect the LLC's unincorporated business gross income. See United States Stationery Company v. State Tax Commission, 57 A.D.2d187, 394 N.Y.S. 2d 88 (3rd Dep't 1977).

B. "Founder" is not subject to UBT.

Section 28-02(a)(7)(i) of Title 19 of the Rules of the City of New York ("RCNY") provides:

"An individual will not be treated as engaged in any trade, business, profession or occupation carried on within or without the City by an unincorporated entity in which such individual owns an interest."

The "Founder" is not deemed to be engaged in an unincorporated business by virtue of owning an interest in LLC. Furthermore, his membership interest in the LLC was not part of a separate IT management or hospitality management business. Therefore, any income or gain from the business received by this individual, including from the sale of his membership interest, is not taxable for purposes of the UBT.

Very truly yours,

Dara Jaffee
Acting General Counsel
Office of Legal Affairs

CS:cs