myStateTaxOffice

A Washington National Tax Services (WNTS) Publication

August 10, 2012

Follow @twitter

California - Gain from the sale of a partnership interest to a non-corporate entity is not deferred under the combined reporting intercompany transaction regulations

Authored by: Michael Santoro

In brief

California's combined reporting intercompany transaction regulations are applicable to transactions between corporations that are members of the same combined reporting group. The sale of a partnership interest from a corporation to a disregarded LLC whose sole owner is a partnership does not qualify as a transaction between corporations. Accordingly, any gain resulting from the partnership interest sale would not be deferred under the intercompany transaction regulations. Rather, the sale should be currently recognized by the seller corporation. [California Franchise Tax Board Chief Counsel Ruling 2012-02 (7/26/12)]

In detail

Chief Counsel Ruling 2012-02 addressed the sale of a partnership interest from a corporation (through a disregarded entity) to a disregarded LLC whose sole owner was a partnership. In return, the corporation received a note receivable in the amount of the fair market value of the partnership interest. All involved entities are unitary with one another.

California Code of Regulations, title 18, section 25106.5-1(a)(1) provides that gains and losses from intercompany transactions between corporate members of the same combined reporting group are generally deferred. Because the disregarded LLC is treated as a division of a partnership (rather than a corporation), it is not considered to be a member of the corporation's combined reporting group. Accordingly, since the transaction is not between corporations that are members of the same combined reporting group, the California Franchise Tax Board concludes that the combined reporting intercompany transaction rules do not apply. Any gain resulting from the partnership sale would not be deferred.

Since California's combined reporting intercompany transaction regulations are inapplicable, other statutory provisions would control. The seller corporation would currently recognize a gain to the extent the fair market value of the note receivable exceeds its basis in the partnership interest. Additionally, the gain would be treated as apportionable business income.

Actions to think about

A footnote to the ruling states that proceeds from the sale of the partnership interest, even though includible in apportionable business income, should not be included in the sales factor based on the substantial/occasional sale rule at California Code of Regulations Section 25137(c)(1)(A)1. Taxpayers dealing with intercompany partnership sales should be reminded of the listed transactions identified in FTB Notice 2011-01, *Abusive Tax Shelters - California Listed Transactions - Abusive Sales Factor Manipulation*.

Let's talk

If you have any questions regarding the Chief Counsel Ruling, please contact one of the following individuals

Ligia Machado
Partner
(916) 930-8260
ligia.l.machado@us.pwc.com

Kathy Freeman
Managing Director
(916) 930-8408
kathy.freeman@us.pwc.com

Alan Bollinger
Director
(916) 930-8203
alan.d.bollinger@us.pwc.com

Elaine Warneke
Director
(916) 930-8321
elaine.s.warneke@us.pwc.com