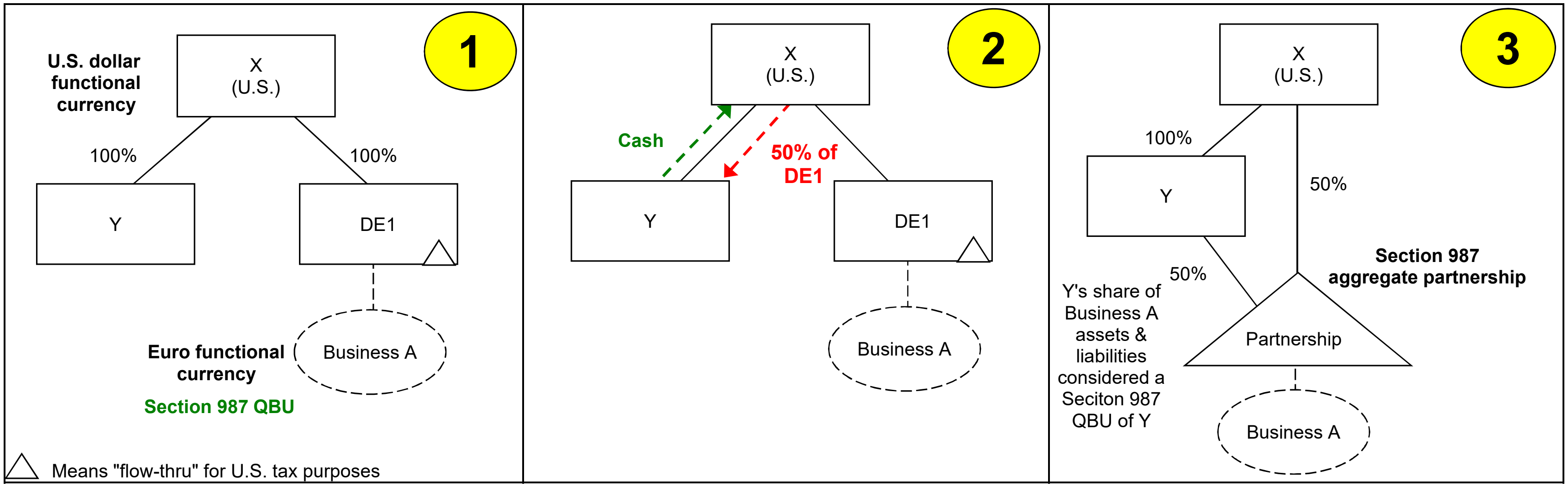
Reg. 1.987-2(c)(10), Ex. 8

Section 987: Conversion of Disregarded Entity To P'ship via Sale

Initial Structure | **Acquisition of 50% of DE1** | **Ending Point**



X and Y are domestic corporations, have the U.S. dollar as their functional currency, and use the calendar year as their taxable year. X owns all of the stock of Y and all of the interests in DE1, a disregarded entity. DE1 owns Business A. Business A is an eligible QBU that has the euro as its functional currency. Y acquires 50 percent of the DE1 interests from X for cash.

DE1 is converted to a partnership when Y purchases the 50 percent interest in DE1. For Federal income tax purposes, Y's purchase of 50 percent of X's interest in DE1 is treated as the direct purchase of 50 percent of the assets of Business A because DE1 is disregarded and Business A is treated as held directly by X. Immediately after the sale of 50 percent of Business A to Y, X and Y are treated as contributing their respective interests in the assets of Business A to a partnership. See Rev. Rul. 99-5 (1999-1 CB 434) (situation 1) and Treas. Reg. §601.601(d)(2).

For purposes of Treas. Reg. §1.987-2(c), these deemed transactions are disregarded transactions. Under Treas. Reg. §1.987-1(b)(5)(i), the newly formed partnership is a section 987 aggregate partnership because X and Y own all the interests in partnership capital and profits, X and Y are related within the meaning of section 267(b), and the requirements of Treas. Reg. §1.987-1(b)(5)(i)(B) are satisfied. Because Y is a partner in a section 987 aggregate partnership that owns Business A and because Y and Business A have different functional currencies, Y's portion of the Business A assets and liabilities constitutes a section 987 QBU of Y.

As a result of the conversion of DE1 to a partnership, Y acquires an allocable share of 50 percent of the assets and liabilities of Business A, as determined under §1.987-7. Accordingly, 50 percent of the assets and liabilities of Business A cease being reflected on the books and records of X's section 987 QBU. Under Treas. Reg. §1.987-2(b)(5), these amounts are treated as if they are transferred from X's section 987 QBU to X, and X is treated as transferring these assets and liabilities to Y. Accordingly, the assets and liabilities of Business A allocated to Y are treated as transferred by Y to Y's newly formed Business A section 987 QBU.