

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

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CC:PSI:6 PLR-111089-00
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May 21, 2001

Legend:

Taxpayer =

P1 =

P2 =

P3 =

P4 =

B1 =

B2 =

W1 =

W2 =

D1 =

D2 =

D3 =

D4 =

D5 =

PLR-111089-00

Dear _____ :

This letter responds to a letter dated D1, and supplemental information, submitted on behalf of Taxpayer requesting a ruling on whether Taxpayer and other third parties are related persons under section 1239(b) of the Internal Revenue Code.

Facts

Taxpayer represents that the facts are as follows:

B1 and B2 are brothers. B1 and W1 are husband and wife. B2 and his wife, W2, have five children. B2 and W2 established three trusts, P2, for their benefit and for the benefit of their children.

Taxpayer is a limited liability company. The members of Taxpayer are B1 and W1. Each has a 50 percent membership interest in Taxpayer. Each member's interest in the profits and losses of Taxpayer corresponds to the member's respective membership interest. Although Taxpayer was formed on D4, it currently does not have any assets, income, or business, and has not applied for or obtained an employer identification number.

P1 is a corporation engaged in the business of making concrete including the extraction of sand. P1 is owned 100 percent by B1 and W1.

P3 is a corporation engaged in the business of extracting sand. P3 owns certain equipment and operating permits used in connection with its business. P3 changed its name to P4 on D3. P3 is owned 100 percent by B2, W2, and/or P2. B2, W2, and P2 own certain tracts of land with improvements thereon which are used in the sand extraction business.

On D2, P3, B2, W2, and P2 entered into an Operating Lease and Land Purchase Option agreement with P1 and Taxpayer, which is effective on D2 and terminates on D5. Under the terms of the Operating Lease, P3 gave P1 an operating lease to take over, manage, and operate P3's sand extraction business, and B2, W2, and P2 gave P1 an operating lease covering certain real estate.

Under the terms of the Purchase Option, P3 gave Taxpayer an option to purchase P3's entire sand extraction business, which includes certain equipment and operating permits used in connection with the sand extraction business, and B2, W2, and P2 gave Taxpayer an option to purchase certain real estate (with improvements thereon) used in connection with the sand extraction business. The options held by Taxpayer to purchase the sand extraction business and the real estate are exercisable at any time during the term of the agreement.

PLR-111089-00

Taxpayer proposes to exercise its option to purchase all of the assets of P3 used in the sand extraction business and all of the real estate owned by B2, W2, and P2 used in connection with the sand extraction business. Taxpayer will be the sole buyer. No assets will be purchased by P1. The terms of the Purchase Option require, in part, that the parties request and obtain a formal opinion or a letter ruling from the Internal Revenue Service determining that the buyer (Taxpayer) is not a related person to any seller (P3, B2, W2, and P2) within the meaning of section 1239.

Rulings Requested

Taxpayer requests the following rulings:

1. Taxpayer is not a related person to P3 under section 1239(b); and
2. Taxpayer is not a related person to B2, W2, and P2 under section 1239(b).

Law and Analysis

Section 1239(a) provides that in the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor is treated as ordinary income if such property is, in the hands of the transferee, of a character that is subject to the allowance for depreciation provided in section 167.

Section 1239(b) provides that for purposes of section 1239(a), the term "related persons" means (1) a person and all entities that are controlled entities with respect to such person, (2) a taxpayer and any trust in which such taxpayer (or spouse) is a beneficiary, unless such beneficiary's interest in the trust is a remote contingent interest within the meaning of section 318(a)(3)(B)(i), and (3) except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

Section 1239(c) defines the term "controlled entity" for purposes of section 1239 as meaning, with respect to any person, a corporation more than 50 percent of the value of the outstanding stock of which is owned (directly or indirectly) by or for such person, a partnership more than 50 percent of the capital interest or profits interest in which is owned (directly or indirectly) by or for such person, and any entity which is a related person to such person under paragraph (3), (10), (11), or (12) of section 267(b).

Section 1239(c)(2) provides that for purposes of section 1239, ownership shall be determined in accordance with rules similar to the rules under section 267(c) (other than paragraph (3) thereof).

Section 267(b)(2) defines an individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual as related parties.

PLR-111089-00

Section 267(b)(3) defines two corporations which are members of the same controlled group as related parties. Section 267(f) states that the term "controlled group" has the same meaning given to the term by section 1563(a), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a), and the determination shall be made without regard to section 1563 (a)(4) and (e)(3)(C).

Section 1563(a)(2) provides, in part, that two corporations will constitute a controlled group if five or fewer persons who are individuals, estates, or trusts own stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of all classes of the stock of each corporation.

Section 267(b)(8) defines a fiduciary of a trust and a corporation as related parties if more than 50 percent in value of the outstanding stock of the corporation is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust.

Section 267(b)(10) defines as related parties a corporation and a partnership, if the same persons own more than 50 percent in value of the outstanding stock of the corporation, and more than 50 percent of the capital interest, or the profits interest, in the partnership.

Section 267(b)(11) defines as related parties an S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation.

Section 267(b)(12) defines as related parties an S corporation and a C corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation.

Section 267 also provides rules for determining the constructive ownership of stock and of partnership interests. Section 267(c)(2) states that an individual shall be considered as owning the stock owned, directly or indirectly, by or for his family, and section 267(c)(4) provides that the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

The section 267 constructive ownership rules limit the extent to which stock constructively owned by one person will, as a result of that constructive ownership, be deemed to be constructively owned by another person. Thus, section 267(c)(5) provides, in part, that stock constructively owned by a person by reason of the application of section 267(c)(2) (family attribution) shall not be treated as owned by that person for the purpose of again applying section 267(c)(2) in order to make another the constructive owner of such stock. The section 267 constructive ownership rules for stock are extended to partnership interests by section 267(e)(3), which provides, in

PLR-111089-00

relevant part, that for purposes of determining ownership of a capital interest or profits interest of a partnership, the principles of section 267(c) (the stock constructive ownership rules) shall apply.

In determining constructive ownership of stock for purposes of the section 267 controlled group provisions, however, the constructive ownership rules of section 1563 (and not those of section 267(c)) are to apply. See Staff of the Joint Committee on Taxation, 98th Cong., 2d Sess., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, 544 n. 23 (Comm. Print 1984).

The constructive ownership rules of section 1563(e) provide, in part, that an individual shall be considered as owning stock in a corporation owned, directly or indirectly, by the individual's spouse or minor children. In addition, an individual who owns more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of shares of all classes of stock in a corporation shall be considered as owning the stock in such corporation owned, directly or indirectly, by or for the individual's parents, grandparents, grandchildren, and adult children. Pursuant to section 1563(f)(2)(B), stock constructively owned by an individual by reason of the section 1563 family constructive ownership rules shall not be treated as owned by that individual for purposes of again applying the section 1563 constructive ownership rules in order to make another individual the constructive owner of such stock.

Assuming Taxpayer, the buyer, is treated as a partnership for federal income tax purposes, Taxpayer would be related to P3 if the same persons own more than 50 percent in value of the outstanding stock of P3 and more than 50 percent of the capital interest, or the profits interest, in Taxpayer. Assuming through a combination of the constructive ownership rules that B2 would be considered to own 100 percent of the stock of P3, the question is what percentage of Taxpayer would B2, or any member of his family, be deemed to own.

B1 owns by himself 50 percent of Taxpayer. Through the constructive ownership rules of section 267, B1 would be deemed to own all the interests in Taxpayer because the other 50 percent of Taxpayer is owned by his wife, W1. With respect to the reattribution of B1's partnership interest to B2, his brother, section 267(c)(5) limits the reattribution to the interests actually, and not constructively, owned by B1. Consequently, through the section 267 constructive ownership rules, B2 only owns the capital interest or profits interest of Taxpayer actually owned by B1, 50 percent, and therefore, no same person owns more than 50 percent of the stock of P3 and more than 50 percent of the interests in Taxpayer.

If Taxpayer was treated as a corporation for federal income tax purposes, the parties would also not be related because under the section 1563 constructive ownership rules a brother is not deemed to own the stock of his brother.

Likewise, B2, W2, and P2, as sellers of the real estate, would not be related

PLR-111089-00

parties to Taxpayer, the buyer of the real estate. Under either section 267(b)(2) or section 267(b)(8), only B1's actual 50 percent ownership of Taxpayer would be constructively owned by his brother, B2. Accordingly, neither B2, W2, nor P2 would be deemed, through the section 267 constructive ownership rules, to own more than 50 percent of Taxpayer.

Conclusions

Accordingly, based solely on the representations and relevant law and analysis as set forth above, we conclude that Taxpayer is not a related person to P3 under section 1239(b), and that Taxpayer is not a related person to B2, W2, and P2 under section 1239(b).

Except as specifically ruled upon above, no opinion is expressed or implied concerning the federal income tax consequences of the transaction described above. Specifically, we express no opinion on the appropriateness of the allocation of the consideration among the assets transferred from P3 to Taxpayer and from B2, W2, and P2 to Taxpayer.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to Taxpayer's authorized representative. We are also sending a copy of this letter to the appropriate Chief, Planning and Special Programs, SB/SE.

Sincerely,
KATHLEEN REED
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures(2):
Copy of this letter
Copy of section 6110