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Person to Contact:

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Date:

March 11, 2003

Distributing =

Controlled =

A =

B =

C =

D =

State X =

e =

g =

h =

Date I =

i =

crop k =

crop m =

n =

Date O =

p =

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Dear _____ :

This is in response to your letter dated August 29, 2002, submitted on behalf of the above-indicated taxpayers, requesting rulings on the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated November 1, December 4, and December 10, 2002, and letters dated January 18 and March, 3, 2003.

Distributing is a State X corporation that owns and operates two farms. Distributing has been engaged in farming, i.e., raising crop k and crop m, since 1982. Distributing has an e fiscal year end and utilizes an inventory method of accounting which is a combination of the cash method of accounting (for expense recognition purposes) and inclusion of inventories of crop k and crop m (for income recognition purposes).

Distributing has outstanding g shares of one class (class A) of voting common stock owned by the Estate of A. AA@ was the sole shareholder and sole officer of Distributing until his death on Date I. Under the terms of A-s last will and testament, C and D, A-s surviving son and daughter, respectively, are co-executors of A-s estate and are due to inherit in equal part (h shares each) all of A-s Distributing shares. It has been represented that C and D each will receive h shares of Distributing stock from the Estate of A prior to the consummation of the proposed transaction described below. Distributing also has outstanding \$ j of p percent debenture bonds. All such securities are owned by B, the mother of C and D. Other than the class A voting common stock and the debenture bonds, there are no other outstanding interests in Distributing. It has been represented that the debenture bonds do not constitute a stock interest in Distributing.

At a special meeting of the Distributing board shortly after the death of A, C and D named themselves directors as well as Vice-President/Secretary and President/Treasurer, respectively, of Distributing and had discussions about the future direction of Distributing. Because C and D had significant differences in philosophy with respect to both operating activities and future investments of Distributing, it was decided, at another special meeting, that Distributing would lease its farm real estate on a cash rent basis for the n crop year pending the probate of A-s estate, the distribution of A-s Distributing shares equally to C and D, and the separation of Distributing-s assets equally between C and D. We have received financial information indicating that Distributing-s farming business has had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years ending on Date Q, the date the farm real estate was leased for a one-year term following the death of A and pending both the probate of A-s Estate and the separation of Distributing-s assets equally between C and D.

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C, an experienced farm manager, believes more risks should be taken in operating the farming business, including leveraging Distributing's nearly debt-free status to purchase additional real estate. D, on the other hand, is not a risk-taker and believes that Distributing should minimize revenue risks by crop revenue insurance. She also is against purchasing additional real estate and believes that Distributing should always maintain debt-free status once such status is achieved. C and D have referred to their irreconcilable differences as a form of deadlock that is having an adverse effect on the day-to-day operations of Distributing. This deadlock has already caused Distributing to forego the purchase of additional land and caused it to cash lease its farm land for the n crop year.

Accordingly, C and D have decided to divide Distributing's farming business and to go their separate ways. It is proposed that Distributing will transfer one of its two farms and one-half of all other business assets to a newly-formed Controlled in exchange for h shares of Controlled stock and Controlled's assumption of one-half of its liabilities (including one-half of the outstanding debenture bond liability). Distributing will distribute all of its h shares of Controlled stock to D in exchange for all of D's h shares of Distributing stock. Immediately afterwards, C will own all of the outstanding stock of Distributing (which will own and operate one farm), and D will own all of the outstanding stock of Controlled (which will own and operate the other farm). Both C and D will be engaged in the active conduct of the farming business of Distributing and Controlled, respectively, including, but not limited to, purchasing all of the crop inputs (seed, chemicals, fertilizer, etc.), assuming all risks and rewards associated with crop input costs, crop yields, crop prices, and government subsidies, and marketing and selling the crops produced on their respective farms.

The taxpayers have made the following representations in connection with the proposed transaction.

- (a) The fair market value of the Controlled stock received by D will be approximately equal to the fair market value of the Distributing stock surrendered by D in the exchange.
- (b) No part of the consideration to be distributed by Distributing will be received by D as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The 5 years of financial information submitted on behalf of Distributing is representative of the corporation's present operations, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statement submitted.
- (d) Following the transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all of the integrated activities of the farming business conducted by Distributing prior to the consummation of the transaction.

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- (e) The distribution of the stock of Controlled is carried out for the following corporate business purpose: to allow C and D to go their own way. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) Distributing is not an S corporation (within the meaning of §1361(a) of the Internal Revenue Code) and there is no plan or intention by Distributing or Controlled to make an S election pursuant to §1362(a).
- (g) There is no plan or intention by the shareholders of Distributing to sell, exchange, transfer by gift, or otherwise dispose of any of their stock in either Distributing or Controlled after the transaction.
- (h) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction.
- (i) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (j) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing each equals or exceeds the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.
- (k) The liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.
- (l) No property is being transferred between Distributing and Controlled upon which any investment credit determined under § 46 has been or will be claimed.
- (m) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (n) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of the Controlled stock.

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- (o) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (p) No two parties to the transaction are investment companies as defined in §368(a)(2)(F)(iii) and (iv).
- (q) The distribution is not part of a plan or series of related transactions within the meaning of §355(e) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote or stock possessing 50 percent or more of the total value of all classes of stock of Distributing or Controlled.

Based solely on the information submitted and on the representations set forth above, we hold as follows:

- (1) The transfer by Distributing of one of its two farms and one-half of all other business assets to Controlled in exchange for h shares of Controlled stock and Controlled's assumption of one-half of its liabilities (including one-half of the outstanding debenture bond liability), as described above, followed by Distributing's distribution of all of the stock of Controlled to D, in exchange for all the shares of Distributing stock held by D, will be a reorganization within the meaning of §368(a)(1)(D). Distributing and Controlled each will be "a party to a reorganization" within the meaning of §368(b).
- (2) Distributing will recognize no gain or loss upon the transfer of a portion of its assets to Controlled solely in exchange for the stock of Controlled and the assumption of liabilities, as described above (§§ 361(a) and 357(a)).
- (3) Controlled will recognize no gain or loss upon the receipt of a portion of Distributing's assets in exchange for Controlled stock, as described above (§1032(a)).
- (4) Distributing will recognize no gain or loss upon its distribution of all of the Controlled stock to D in exchange for all of D's Distributing stock (§361(c)(1)).
- (5) Controlled's basis in the assets received in the proposed transaction will equal the basis of such assets in the hands of Distributing immediately prior to the proposed transaction (§362(b)).

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- (6) Controlled's holding period of the assets received in the proposed transaction will include the period during which such assets were held by Distributing (§1223(2)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) D upon receipt of the Controlled stock in exchange for D's Distributing stock (§355(a)(1)).
- (8) The basis of the Controlled stock in the hands of D immediately after the proposed transaction will be the same as the basis of the Distributing stock surrendered by D in exchange therefor (§358(a)(1)).
- (9) The holding period of the Controlled stock received by D will include the holding period of the Distributing stock surrendered in exchange therefor, provided such stock is held as a capital asset on the date of the transaction (§1223(1)).
- (10) As provided in § 312(h), proper allocation of earnings and profits will be made between Distributing and Controlled in accordance with §1.312-10(a) of the Income Tax Regulations.

We express no opinion about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above rulings.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayers and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for a ruling. Verification of the information, representations, and other data may be required as part of the audit process.

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

It is important that a copy of this letter be attached to the Federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this letter is consummated.

Sincerely,

Richard E. Coss
Senior Counsel, Branch 3
Office of Associate Chief Counsel (Corporate)