Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Number: **200102028**
Release Date: 1/12/2001
Index Number: 7704.05-00

Person to Contact:

Telephone Number:

Refer Reply To:
PLR-108918-00 CC:PSI:3
Date:
October 10, 2000

LEGEND

PRS =

GP =

Company =

Corp =

Sub1 =
Sub2 =

Parent =

State1 =
State2 =

Area1 =
Area2 =
Area3 =

Crop1 =
Crop2 =

Product1 =
Product2 =

Operation =

Year1 =
Year2 =
Year3 =
Year4 =

Year5 =
Year6 =
Year7 =
Year8 =
Year9 =
Year10 =

Date1 =
Date2 =

Month =

N1 =
N2 =
N3 =
N4 =
N5 =
N6 =
N7 =
N8 =
N9 =
N10 =
N11 =
N12 =
N13 =
N14 =
N15 =

Dear

This responds to a letter submitted on April 18, 2000, on behalf of PRS by your authorized representative requesting a ruling that PRS's proposed acquisition of certain farming operations and its performance of farming services for itself and third parties will be deemed "closely related" and not be deemed a "substantial new line of business" within the meaning of § 1.7704-2(d)(1).

Facts

PRS was organized on Date1 as a master limited partnership in State1. The general partner of PRS is GP, a State2 corporation. On Date2, PRS filed a registration statement with the Securities and Exchange Commission under the Investment Company Act of 1940 and the Securities Act of 1933. PRS underwent an initial public offering of its units shortly thereafter. The formation of PRS and the initial public offering of its units were part of a financing plan to facilitate the purchase of Company

by certain investors.

Company began business operations in Year1 in State2. Company initiated Crop1 operations in Year2. This entailed farming Crop1, planted on owned or leased land, harvesting, processing Crop1 in its own factories in order to make Product1, refining Product1 through a cooperative in which it was a member, and finally, through the cooperative, selling refined Product1 to wholesalers or directly to customers.

In Year3, through a subsidiary [Subsidiary], Company launched Crop2 operations. It planted Crop2 trees on lands it or its subsidiaries owned or leased in Area1. Subsidiary then performed the necessary farming operations on the lands, including fertilizing, weeding, pruning, etc. Subsidiary also harvested Crop2 and transported them to a processing plant owned by Corp. Corp processed Crop2 and marketed the end products.

In Year4, Company acquired Corp, which itself owned about N1 tree acres of Crop2 orchards in Area2. Corp farmed the orchards, harvested Crop2, processed Crop2 at a processing plant located on the land and marketed Crop2 throughout the United States and the world. Over time, Corp's farming operations were taken over by Sub1, a Company subsidiary.

Beginning in Year5, Company (or its subsidiaries) sold certain of its Crop2 orchards to unrelated third parties. The third party properties are either adjacent to, surrounded by, or in close proximity to the remaining Company farms. These third parties generally did not have the capability to conduct farming operations, so either Sub1 or Sub2, another Company subsidiary, depending primarily upon geographical location, entered into farming contracts with the third parties to perform all farming, harvesting, and Operation operations for the purchasers. Corp entered into Crop2 purchase contracts with the third parties, whereby Corp agreed to purchase Product2 at prices set forth in a formula in the contracts. Thus, at each of the orchards, no matter if owned by Company, a Company subsidiary, or a third party investor, Sub1 or Sub2 performed the farming operations, performed all harvesting and Operation of Crop2, and finally sold Crop2 to Corp, which processed Crop2 in Area2.

In Year6, Parent, which had acquired control of Company in the prior decade, decided to divest itself of the Company investment. It was at this time that Company management and other investors formed PRS as a part of a financing plan to facilitate the acquisition of Company from Parent. Upon formation, PRS sold N2 partnership units to the public for about $N3. The funds from the public offering were used to purchase about N4 acres of Crop2 orchards from Company.

Following the public offering, PRS entered into a Crop2 purchase contract with Corp to sell Product2. PRS also outsourced its farming operations to Sub1 and Sub2 who performed all farming, harvesting, and Operation operations for PRS. This

relationship continues to date: Sub1 performs the farming operations for PRS in Area1 and Area2, and Sub2 performs the farming operations in Area3. Sub1 owns an administrative office building, various field equipment such as tractors, harvesting equipment, trucks, etc., an Operation plant, a well, irrigation lines, office equipment such as computers; in short, all equipment and other assets necessary to farm Crop2 orchards, both for Company and its subsidiaries and for outside owners of Crop2 orchards. Sub2 also owns assets of the same type.

PRS could not acquire the Company Crop2 farming operations at the time PRS was formed because the Crop1 and Crop2 farming activities at Sub1 were conducted as a coordinated operation. At that time Sub1 still operated a large Crop1 plantation and had a substantial amount of equipment that could be used for both Crop1 and Crop2 farming operations. The same was true of the employees, who could be shifted back and forth. Therefore, PRS's farming operations were outsourced to Sub1 to preserve economies of scale.

In Month of Year6, PRS purchased additional orchards from Company. In Year7 it purchased additional orchards after making a second public offering of partnership units. In Year8 it purchased a small orchard from another investor. In each instance the farming and Crop2 purchase relationships continued.

Company closed down its Crop1 operations in Area3 in Year9 and in Area1 in Year10. Because the farming operations related to Crop1 utilized the largest part of the equipment and employees of the farming segment of Company's operations, it wishes to withdraw from the Crop2 farming operations now that the Crop1 business has been discontinued. It wishes to sell the Crop2 farming business to PRS.

At the present time, PRS owns Crop2 orchards on land either owned directly by PRS or leased from others. It has continued to outsource its farming operations to date. PRS now wishes to bring the farming operations in-house on its own properties and farm its orchards with its own equipment and employees. Therefore, PRS would like to purchase Company's Crop2 farming business.

If PRS purchased the operation, approximately N5 percent of its overall gross income would be derived from orchards owned by the partnership while approximately N6 percent of the gross income would be derived from the performance of farming operations for outsiders. Thus, PRS would derive the majority of its gross income from the sale of Crop2, not from the performance of farming operations for outside orchards.

It is expected that all accounting functions for the farming portion of the business will continue to be performed in the same manner if the orchards and farming operations are combined again with the purchase of the farming operations by PRS. Prior to the formation of PRS, Sub1 performed all of the accounting functions for the farming portion of the business. It kept records of each individual farm, whether owned

by Company or its affiliates or by third parties. Such records enabled Sub1 itself or any outside purchaser to ascertain how the particular farm was doing from the point of view of (1) fertilizer expenses, irrigation expenses, and all other expenses of operating the farm; (2) yields; and (3) revenues from the sale of Crop2. Each farm was charged an allocable share of the accounting expenses plus a management fee. The system continued without change after the formation of PRS, and, it is anticipated, would carry on unchanged with the purchase of the operations by PRS.

Approximately N7 acres of Crop2 orchards are currently farmed by Sub1 and Sub2 for PRS; approximately N8 acres of orchards are farmed by these entities for other owners; approximately N9 acres are farmed by Sub1 and Sub2 for their own accounts. PRS plans to purchase N10 of the N9 acres. Thus, after the acquisition, it is expected that PRS will farm N11 acres (N12 percent) for its own account and will farm N13 acres for outsider owners (including N14 acres for Sub1 and Sub2 (N15 percent).

PRS has requested a ruling that its acquisition of farming operations from Sub1 and Sub2 and its performance of farming services for itself and third parties will be deemed "closely related" and not be deemed a "substantial new line of business" within the meaning of § 1.7704-2(d)(1).

Analysis

Section 7704(a) provides that a publicly traded partnership will be treated as a corporation.

Section 7704(b) provides that the term "publicly traded partnership" means any partnership if (1) interests in such partnership are traded on an established securities market, or (2) interests in such partnership are readily tradable on a secondary market (or the substantial equivalent thereof).

Section 7704(g) provides an exception for electing 1987 partnerships. An electing 1987 partnership is any publicly traded partnership that was an "existing partnership" as defined in Section 1021(c)(2) of the Revenue Reconciliation Act of 1987 that elects to be treated as a partnership and agrees to pay the tax imposed by section 7704(g)(3). In addition, section 7704(g) provides that an electing 1987 partnership ceases to be treated as a partnership as of the first day after December 31, 1987 on which there has been an addition of a substantial new line of business.

Section 1.7704-2(b)(1) provides, in relevant part, that the term "existing partnership" means any partnership if the partnership was a publicly traded partnership (within the meaning of section 7704(b)) on December 17, 1987, or a registration statement indicating that the partnership was to be a publicly traded partnership was filed with the Securities and Exchange Commission with respect to the partnership on or before December 17, 1987.

Section 1.7704-2(d)(1) provides that a new line of business is any business activity of the partnership not closely related to a pre-existing business of the partnership to the extent that the activity generates income other than "qualifying income" within the meaning of section 7704 and the regulations thereunder.

Section 1.7704-2(d)(2) provides, in relevant part, that a business activity is a pre-existing business of the partnership if the partnership was actively engaged in the activity on or before December 17, 1987.

Section 1.7704-2(d)(3) of the regulations provides that all of the facts and circumstances will determine whether a new business activity is closely related to a pre-existing business of the partnership. The following factors, among others, will help to establish that a new business activity is closely related to a pre-existing business of the partnership and therefore is not a new line of business:

(i) The activity provides products or services very similar to the products or services provided by the pre-existing business.

(ii) The activity markets products and services to the same class of customers as that of the pre-existing business.

(iii) The activity is of a type that is normally conducted in the same business location as the pre-existing business.

(iv) The activity requires the use of similar operating assets as those used in the pre-existing business.

(v) The activity's economic success depends on the success of the pre-existing business.

(vi) The activity is of a type that would normally be treated as a unit with the pre-existing business in the business' accounting records.

(vii) If the activity and the pre-existing business are regulated or licensed, they are regulated or licensed by the same or similar governmental authority.

(viii) The United States Bureau of the Census assigns the activity the same four-digit Industry Number Standard Identification Code as the pre-existing business.

Conclusion

Based solely on the facts as represented, we conclude that the acquisition and operation of the Crop2 farming operations are closely related to PRS's pre-existing business and not the addition by PRS of a new line of business. Therefore, neither the

acquisition nor subsequent operation of the farming operation on its own behalf or for third parties will constitute a new line of business within the meaning of section 7704.

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the facts of this case under any other provision of the Code.

Pursuant to a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

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

Sincerely,
William P. O'Shea
Chief, Branch 3
Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures(2)
Copy of this letter
Copy for 6110 purposes