

Internal Revenue Service

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Taxpayers =

Department of the Treasury

Washington, DC 20224

Person to contact:

Telephone Number:

Refer Reply to:

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Date: January 29, 2001

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d =e =

Company =

f =g =

State =

Agency =

State Statute =

Date 1 =

Date 2 =

h =

Date 3 =

Court =

Date 4 =

Date 5 =

i =

Dear :

This is in reply to your letter of December 2, 1999, and additional submissions dated May 18, 2000, July 27, 2000, and August 20, 2000, on behalf of the above-referenced Taxpayers, seeking a ruling on the reinvestment of proceeds under § 1033 of the Internal Revenue Code.

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It is represented that each Taxpayer has for some time held as an investment a noncontrolling interest (ranging from a minimum of d % to a maximum of e %) in the stock of Company, a privately owned, state regulated utility. Company provided f for end use by customers in g.

The Agency is a special district of State, established and organized pursuant to State Statute. As a public agency, the Agency has the power and authority to initiate eminent domain proceedings. On Date 1, the Agency submitted to the shareholders of Company an offer to purchase all the issued and outstanding shares of capital stock of Company for the purpose of, among other things, providing, delivering and selling f within the Agency's jurisdiction. On Date 2, the Agency adopted h, which authorized the acquisition of the stock of Company by exercise of the power of eminent domain. On Date 3, the Agency filed its eminent domain complaint in Court. Judgment was entered on Date 4, and a Final Order was recorded on Date 5. The condemnation proceeds of \$ i were paid by the Agency on Date 5 and distributed to the Taxpayers. Copies of h and the Final Order were submitted, which clearly indicate that the sale was under threat of condemnation.

Taxpayers propose to reinvest the entire proceeds from the involuntary conversion in public utility common stocks, public utility preferred stocks, and/or public utility mutual funds. A ruling is requested that we rule that the proposed replacement property will constitute "property similar or related in service or use" to the Company stock involuntarily converted, and that gain from the involuntary conversion is eligible for nonrecognition under § 1033(a)(2)(A) if the proceeds are reinvested in the proposed replacement property.

Section 1033(a) provides that, at the election of the taxpayer, gain realized upon the involuntary conversion of property as a result of requisition or condemnation or threat or imminence thereof will be recognized only to the extent that the amount realized upon the conversion is not reinvested in property similar or related in service or use to the converted property.

Generally, replacement property does not qualify as "similar or related in service or use" unless its physical characteristics and end uses are similar to those of the converted property. When an investor owns property that is involuntarily converted, however, the inquiry shifts primarily to the similarity in the relationship of the services or uses which the converted and replacement properties have to the owner-investor. See Rev. Rul. 64-237, 1964-2 C.B. 319. Rev. Rul. 64-237 discusses several factors to consider in determining whether the replacement property is similar to the converted property of the owner-investor, including the nature of the business risks connected with the properties, and the extent and type of management activities the property requires of the owner. Thus, when an investor's property is involuntarily converted, the investor is entitled to consider the manner in which the converted property was held in determining whether the proposed replacement property will be similar or related in service or use.

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The Service generally does not distinguish among various types of equity securities for purposes of § 1033. Rev. Rul. 66-355, 1966-2 C.B. 302, holds that a taxpayer can replace common stock that was involuntarily converted with common stock, preferred stock, or mutual fund shares and treat the replacement property as similar or related in service or use within the meaning of § 1033.

The risks to and management activities required of Taxpayers with respect to Company stock are comparable to the risks of investing in other publicly traded utility capital stocks such as publicly traded utility common stock, preferred stock, and mutual funds. Accordingly, where noncontrolling interests in Company stock are involuntarily converted into money within the meaning of § 1033(a)(2), we rule that reinvestment of the proceeds in public utility common stock, preferred stock, or mutual funds constitutes property similar or related in service or use within the meaning of § 1033(a)(2)(A). An investment in debt instruments, however, would not be similar or related in service or use to converted capital stock for purposes of § 1033, since Taxpayers' relationship to the replacement property and the business risks connected with such properties would be different.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,
Associate Chief Counsel
(Income Tax and Accounting)
By: Douglas A. Fahey
Acting Chief, Branch 5