CONTRIBUTION SCENARIOS

CORPORATE OWNER I

Property is owned by a corporation that is owned by multiple shareholders, but only some of them want to exchange their property.

BUY OUT

If the property has little or no debt, the non-contributors may be bought out by the contributors. To facilitate this transaction, the Fund would loan the contributors the money required to acquire the non-contributors' interest in the company (to secure this loan, the contributors would pledge their units in the Fund).

This loan would remain in place until the contributors fully repaid the note. Until then, it would accrue interest, which would be paid by the contributors' quarterly distributions. This scenario will typically only work if the non-contributors' interest makes up less than 25% of the total value of the property and there is little to no existing debt.

REORGANIZATION

An alternative would be to split up the corporation through a D Reorganization. This will typically only work if the land has less than 25% debt to value and it complies with Section 355(b) of the Internal Revenue Code.

In this scenario, the land would be physically split so that the value of each parcel is proportionate to the value of each shareholder group's interest: those that want to contribute their land to the fund (the A Group) and those that don't (the B Group). The corporation then contributes the A Group land to a new wholly owned subsidiary (A Co.).

The corporation contributes the B Group land to a separate wholly owned subsidiary (B Co.). Now the corporation owns two subsidiaries: one that owns the fund units and one that owns land.

If there was debt on the whole of the land prior to the split, new separate loans will be required. The corporation then engages in a D Reorganization and distributes A Co. to the A Group and B Co. to the B Group. Later, A Co. contributes the land to the fund.

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CONTRIBUTION SCENARIOS

CORPORATE OWNER I, PAGE 2

Property is owned by a corporation that is owned by multiple shareholders, but only some of them want to exchange their property.

REORGANIZATION I, CONTINUED

If the property is secured by a mortgage that is not assignable, the fund would loan the contributors the money required to pay off the existing debt (to secure this loan, the contributors would pledge their units in the fund). This loan would remain in place until the contributors fully repaid the note. (Continued on page 2)

Until then, the note would accrue interest, which would be paid by the contributors' quarterly distributions.

Importantly, to avoid recognizing a gain on the distribution of A Co. and B Co. to the shareholders, the transaction must comply with Section 355(b) of the code, which requires that the distributing and controlled corporations be engaged, immediately after the distribution, in the active conduct of a trade or business that has been actively conducted through the 5-year period ending on the date of distribution.

If the corporation has been merely cash renting the farm during this period, it will probably not comply with this requirement and the shareholders will recognize a gain. Whether such a transaction can be done on a tax deferred basis requires careful analysis and is fact specific. Please consult with your tax advisor before proceeding.

SOWER
LEGACY FARMLAND FUND

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