OKLAHOMA TAX COMMISSION

TAX POLICY DIVISION
RICK MILLER, DIRECTOR

PHONE (405) 521-3133
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Re: Our file number LR 05-085 Income Tax - Capital Gain Deduction

Dear

This is in response to your inquiry of May 13, 2005 wherein you requested guidance regarding the Capital Gain deduction found in 68 O.S. § 2358. Following is a restatement of the facts in your letter, the questions posed and our response thereto.

FACTS - Situtation One:

When a shareholder of an S Corporation (a pass-through entity) transfers a capital asset in exchange for stock in such corporation, pursuant to IRC § 351 to the entity, IRC § 1223 and Treasury Regulation §1.1223-1 provide that the property maintains the same holding period and adjusted basis as it had in the hands of the transferor (shareholder).

QUESTION AND OTC RESPONSE - Situation One:

Assume that a particular piece of property (capital asset) had been held by an individual for three years. Such individual contributes the property to an S Corporation in a transaction qualifying for IRC § 351 (tax free incorporation) and § 1223 (tacking of holding period). Subsequent to the transfer, the pass-through entity holds the property for more than two years.

If the property is sold after the five year total holding period, will the contributing shareholder be permitted to exclude such capital gain from their Oklahoma income tax return?

Yes, provided the S-Corporation is recognized under IRC § 1223 as holding the asset as of the original date of acquisition (over 3 years) of the individual that contributed the asset.

FACTS - Situtation Two:

When a partner or a member of a Partnership or Limited Liability entity transfers a capital asset to the entity, IRC § 1223 also applies.

QUESTION AND OTC RESPONSE - Situation Two:

Assuming the same fact pattern as set forth in the question immediately above, will the contributing partner/member be permitted to exclude such capital gain from their Oklahoma income tax return since the holding period pursuant to IRC § 1223 will be in excess of five years?

Yes, provided the partnership or limited liability entity is recognized under IRC § 1223 as holding the asset as of the original date of acquisition (over 3 years) of the contributing partner/ member that contributed the asset.

You had also inquired as to whether mineral interests are tangible property subject to the capital gain exclusion. Please be advised that it is the opinion of this office that capital gains from the sale of mineral interests are excluded providing the five (5) year holding period is met.

This response applies only to the circumstances set out in your request of May 13, 2005. Pursuant to Commission Rule 710:1-3-73(e), this Letter Ruling may be generally relied upon **only** by the entity to whom it is issued, assuming that all pertinent facts have been accurately and completely stated, and that there has been no change in applicable law.

If I can be of further assistance, please feel free to call me at (405) 521-3133.

Sincerely,

FOR THE OKLAHOMA TAX COMMISSION

Michael C. Kaufmann
Tax Policy Analyst