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LEGEND:

Taxpayer = * * *

Brother = * * *

Deceased Brother = * * *

Niece = * * *

Country X = * * *

State Y = * * *

City Z = * * *

Blackacre = * * *

Greenacre = * * *

Year 1 = * * *

Year 2 = * * *

Date 3 = * * *

\$6 = * * *

\$3 = * * *

Dear * * *

This responds to your request for a private letter ruling dated January 29, 2007. Specifically, you are asking for a ruling that § 1031(f) of the Internal Revenue Code does not apply to trigger recognition of gain realized in a proposed exchange of like-kind properties.

FACTS

The proposed transaction is an exchange of partial interests in two parcels of real property between related persons and the sale of one of those parcels to City Z within two years of the exchange. Parties to the proposed transaction are Taxpayer, Brother, an irrevocable trust of Deceased Brother (Trust) and Niece, who is the daughter of Deceased

Brother and sole beneficiary of Trust. Taxpayer is trustee of said Trust. Niece is a resident of Country X. Taxpayer and Brother are residents of State Y. Taxpayer, Brother and Trust are equal tenants in common of Blackacre and Greenacre (sometimes referred to as "Properties") located in City Z.

Taxpayer, Brother and Deceased Brother inherited the Properties on the death of their mother in Year 1. Later, Deceased Brother transferred his interest in the Properties to a revocable intervivos trust. This was a grantor trust for federal income tax purposes so that he remained a part owner of the Properties for federal income tax purposes.

Deceased Brother died in Year 2. Under Article II.B. of the Trust Declaration, nearly all of Deceased Brother's estate, including his interest in the Properties, was to be distributed outright and free of trust to Niece. However, difficulties involved in dealing with the undivided interests in the Properties have delayed the distribution of the Properties from Trust.

Taxpayer has been the trustee of Trust and has been managing the properties for all three owners. Prior to the exchange and sale described below, Taxpayer will resign as trustee. Under Article VI.A. of the Trust Declaration, Niece will become successor trustee upon the resignation of Taxpayer. Therefore, at the time of the exchange and sale, Taxpayer will have no fiduciary or § 267(b) relationship to Niece or the Trust. Niece, as trustee of Trust and as the sole beneficiary will be both the legal and beneficial owner of the Trust's interest in the two Properties. Additionally, Niece is already entitled to immediate distribution of the Trust Corpus. Thus, for purposes of this ruling, Niece is treated as a one-third owner of the Properties.

Brother and Niece want to sell the Properties and use their share of the sale proceeds for other investment and personal purposes. Taxpayer prefers to remain invested in real estate, preferably in one of the Properties, but wishes to be relieved of the burden of managing the Properties for the benefit of Brother and Niece. Accordingly, Taxpayer sought buyers for the Properties. City Z expressed interest in acquiring both Properties or in acquiring Greenacre alone. On Date 3, representatives of City Z endorsed a nonbinding letter of intent to purchase Greenacre for \$6 and to cooperate with sellers in structuring the transaction as a § 1031 exchange.

Greenacre's fair market value is \$6 and Blackacre's is about \$3. Thus, each of the owner's 1/3 interest in the combined Properties is worth about \$3, the one-third interest each has in Greenacre being worth about \$2 and the one-third each has in Blackacre, about \$1. Taxpayer, Brother and Niece have agreed that Taxpayer will exchange his one-third interest in Greenacre (worth approximately \$2) for Brother's and Niece's combined two-third interest in Blackacre (worth approximately \$2), the "exchange" referred to in the ruling request. Following the exchange, Brother and Niece would each own one-half of Greenacre (each half worth \$3). They would then sell that property to City Z for \$6 and split the proceeds. Taxpayer will retain full ownership of Blackacre (worth about \$3) and continue renting it to commercial tenants.

APPLICABLE LAW

Section 1031(a)(1) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1031(f)(1) provides that if --

(A) a taxpayer exchanges property with a related person,

(B) there is nonrecognition of gain or loss to the taxpayer under this section with respect to the exchange of such property (determined without regard to this subsection), and

(C) before the date 2 years after the date of the last transfer which was part of such exchange --

(i) the related person disposes of such property, or

(ii) the taxpayer disposes of the property received in the exchange from the related person which was of like kind to the property transferred by the taxpayer,

there shall be no nonrecognition of gain or loss under this section to the taxpayer with respect to such exchange; except that any gain or loss recognized by the taxpayer by reason of this subsection shall be taken into account as of the date on which the disposition referred to in subparagraph (C) occurs.

Section 1031(f)(2) provides that for purposes of paragraph (1)(C), there shall not be taken into account any disposition --

(A) after the earlier of the death of the taxpayer or the death of the related person,

(B) in a compulsory or involuntary conversion (within the meaning of § 1033) if the exchange occurred before the threat or imminence of such conversion, or (C) with respect to which it is established to the satisfaction of the Secretary that neither the exchange nor such disposition had as one of its principal purposes the avoidance of federal income tax.

Section 1031(f)(3) provides that for purposes of this subsection, the term "related person" means any person bearing a relationship to the taxpayer described in § 267(b) or 707(b)(1).

Relationships described in § 267(b) include members of a family, as defined in § 267(c)(4), and a fiduciary of a trust and a beneficiary of such trust. Section 267(c)(4) provides that the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

The Senate Finance Committee Report, S. Prt. No. 56, 101st Cong., 1st Sess., 151 (1989) for the Revenue Reconciliation Act of 1989 (P.L. 101-239) (the Report) states, in part:

A disposition also will not invalidate the nonrecognition treatment of the original exchange if it is established to the satisfaction of the Secretary of the Treasury that neither the exchange nor the disposition had as one of its principal purposes the avoidance of [f]ederal income tax. It is intended that the non-tax avoidance exception generally will apply to: (i) a transaction involving an exchange of undivided interests in different properties that results in each taxpayer holding either an entire interest in a single property or a larger undivided interest in any of such properties . . .

The Conference Committee adopted the Senate Amendment. H.R. Rep. No. 386, 101st Cong., 1st Sess. 613 (1989).

Section 1031(f)(4) provides that § 1031 shall not apply to any exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection.

LEGAL ANALYSIS and CONCLUSION

Taxpayer and Brother are related persons under § 267(b)(1) and (c)(4). Also, Taxpayer, prior to his resignation as trustee of Trust, and Niece are related persons under § 267(b)(6) because Taxpayer is the trustee of the trust holding title to undivided interests in the Properties and Niece is the beneficiary of that Trust. In addition, the sale to City Z of some of the property exchanged (Greenacre) will occur within two years of the exchange. Accordingly, the sale to City Z of Greenacre is a disposition described in § 1031(f)(1)(C).

As discussed above, a disposition described in § 1031(f)(1)(C) results in recognition of gain unless the disposition is described in § 1031(f)(2), including § 1031(f)(2)(C), which describes a situation where neither the exchange nor the subsequent disposition had as one of its principal purposes the avoidance of tax. In the present case, prior to the disposition of Greenacre to City Z, there will be an exchange of undivided interests in which the exchanging parties receive either a whole interest in property or a larger undivided interest in property. According to the legislative history underlying § 1031(f), Congress intended that the non-tax avoidance exception of § 1031(f)(2)(C) apply to this specific circumstance involving an exchange of undivided interests in different properties that results in each taxpayer holding either an entire interest in a single property or a

larger undivided interest in any of such properties. Consequently, the parties in the present case do not have (or are deemed to not have) the intent to avoid the federal income tax by the exchange of their undivided interest and subsequent sale of some of the interests being exchanged within two years.

In addition, the conclusion that the parties do not have (or are deemed to not have) the intent to avoid federal income tax has a natural corollary that the transaction (or series of transactions) was not structured to avoid the purposes of § 1031(f). Brother's basis in the Properties is lower than Taxpayer's basis so it is not in the related parties' interest for Brother, rather than Taxpayer, to sell his interest in the Properties. See Rev. Rul. 2002-83, 2002-2 C.B. 927. Further, had the distribution of Properties to Niece occurred as intended on the death of Deceased Brother in Year 2, there would have been no related party issue with respect to Niece under § 1031(f) because Niece and Taxpayer would not have been related persons. The same would be true if Taxpayer resigns as successor trustee, as provided in the original trust agreement, at or near the time of the exchange. Accordingly, we rule as follows:

1. Taxpayer's exchange of his one-third interest in Greenacre, for Brother's and Trust's (Niece's) two-third interest in Blackacre will not be for the principal purpose of avoidance of federal income tax within the meaning of § 1031(f)(2)(C).
2. The transactions describe in this ruling are not structured to avoid the purposes of § 1031(f) within the meaning of § 1031(f)(4).

CAVEAT(S)

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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.

This ruling is directed only to the taxpayer 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. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter showing the deletions proposed to be made when it is disclosed under § 6110. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Michael J. Montemurro Branch
Chief, Branch 4 (Income Tax &
Accounting)