
Private Letter Rulings

Private Letter Ruling 200728008, 07/13/2007, IRC Sec(s). 1031

UIL No. 1031.00-00; 1031.06-00

Exchange of property held for productive use or investment—exchanges between related persons—exchange accommodation titleholders—qualified intermediaries.

Headnote:

Code Sec. 1031; won't apply to trigger recognition of any gain when taxpayer purchases replacement properties from unrelated parties via EAT or QI, taxpayer sells relinquished properties to related party for cash consideration received by QI, and related party disposes of relinquished properties within 2 years of acquisitions.

Reference(s): Code Sec. 1031;

Full Text:

Number: 200728008 Third Party Communication: None

Release Date: 7/13/2007 Date of Communication: Not Applicable

Person To Contact:

Index Number: 1031.00-00, 1031.06-00 ---------- , ID No. ----------

Telephone Number:

---------- Refer Reply To:

---------- CC:IT&A:5

---------- PLR-105512-07

---------- Date:

---------- April 12, 2007

In Re: ———————— ———————————————— ————————- ———————
———- ————————

LEGEND:

Taxpayer = ————————

Taxpayer's ID= ————————

Related Party = ——————————————————-

QI = ——————————

EAT = ——————————————————-

A LLC= ————————————————————

B LLC= ——————————————————————————-

C LLC= ———————————————————————————-

$D = ————————-

$E = ————————-

$F = ————————

Replacement Property #1 = ——————————————————————————
——————— ——————————————————————————————
——————————————

Relinquished Property #1 = ————————————————————————

Replacement Property #2 = ——————————————-

Relinquished Property #2 = ——————————————

Dear ———————————— :

This letter responds to your ruling reques t submitted on behalf of Taxpayer by letter dated January 26, 2007 as to whether nonrecognition treatment under § 1031(a) of the Internal Revenue Code would apply to its transfers of real properties in multi-party exchanges involving a related party and a qualified intermediary.

STATEMENT OF FACTS

We rely on the facts and conditions set forth in Taxpayer's submissions dated January 26, 2007 and March 7, 2007.

Taxpayer and Related Party are related persons within the meaning of § 1031(f)(3). Taxpayer transferred its properties, Relinquished Property #1 and Relinquished Property #2, and acquired Replacement Property #1 and Replacement Property #2 in two separate transactions. In the first transaction, Taxpayer wished to exchange Relinquished Property #1 for Replacement Property #1, which was owned by a party unrelated to Taxpayer, through a reverse like-kind exchange. Taxpayer represents that Relinquished Property #1 is like-kind to Replacement Property #1 within the meaning of § 1031(a) and § 1.1031(a)-1(b). To facilitate this exchange, Taxpayer entered into the following transactions pu rsuant to a qualified exchange accommodation arrangement ("QEAA") set forth in Rev. Proc. 2000-37, 2000-2 C.B. 308, as modified by Rev. Proc. 2004-51, 2004-2 C.B. 294: (1) Taxpayer loaned $D to EAT to purchase Replacement Property #1; (2) EAT purchased Replacement Property #1 for $D from the unrelated party; (3) the unrelated party tr ansferred Replacement Property #1 to A LLC, which is a wholly-owned, single-member limited liability company of EAT; (4) Taxpayer transferred Relinquished Property #1 to Related Party for Relinquished Property #1's fair market value, $E; (5) Related Party transferred $E to QI, which is an affiliate of EAT; and (5) QI transferred Replacement Property #1 (by transferring A LLC, which owned Replacement Property #1) to Taxpayer.

EAT functioned as an exchange accommodation titleholder. QI is a qualified intermediary described in § 1.1031(k)-1(g)(4) and not a "disqualified person" with respect to Taxpayer within the meaning of § 1.1031(k)-1(k). Because A LLC is a disregarded entity for Federal tax purposes, a transfer of A LLC is treated as a transfer of the assets of A LLC. The value of Relinquished Property #1 was lower than the value of Replacement Property #1. Accordingly, Taxpayer sold other like-kind properties through QI to other unrelated parties to cover the difference between $D and $E. QI then repaid the $D loan from Taxpayer that was used by EAT to purchase Replacement Property #1.

In the second transaction, Taxpayer wished to exchange Relinquished Property #2 for Replacement Property #2, which was owned by an unrelated party, through a like-kind exchange. Taxpayer represents that Relinquished Property #2 is like-kind to Replacement Property #2 within the meaning of § 1031(a) and § 1.1031(a)-1(b).

Taxpayer entered into the following transacti ons: (1) Taxpayer transferred Relinquished Property #2 to Related Party by transferring B LLC and C LLC, both single-member limited liability companies, that jointly owned Relinquished Property #2; (2) Related Party paid the fair market value of Relinquished Property #2 in the amount of $F to QI; (3) QI used $F to acquire Replacement Property #2 from a party unrelated to Taxpayer; and (4) QI transferred Replacement Property #2 to Taxpayer.

After the above-transactions, Taxpay er held Replacement Property #1 and Replacement Property #2, and Related Party held Relinquished Property #1 and Relinquished Property #2. Related Party intends to dispose of Relinquished Property #1 and Relinquished Property #2 within two years of the receipts.

LAW AND ANALYSIS

Applicable Requirements for Deferral under § 1031.

Section 1031 was initially promulgated to avoid taxing gains that were mere "paper profits," *i.e.*, the taxpayer had realized nothing tangible and to tax them seriously interfered with normal business adjustments. Revenue Act of 1934, Sec. 112.

Section 1031(a)(1) generally 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.

In arranging the like-kind exchange, § 1.1031(k)-1(g)(4) allows taxpayers to use a qualified intermediary to facilitate a like-kind exchange. A taxpayer's transfer of relinquished property to a qualified intermediary and subsequent receipt of like-kind replacement property from the qualified intermediary is treated as an exchange with the qualified intermediary.

Section 1031(f) was subsequently enacted to accord nonrecognition treatment only to exchanges and conversions where a taxpayer can be viewed as merely continuing his investment. If a related party exchange is followed shortly thereafter by a disposition of the property, the related parti es have, in effect, "cashed out" of the investment, and the original exchange would not be accorded nonrecognition treatment.*See* H.R. REP. NO. 101-247, at 1341 (1989), *reprinted in* 1989 U.S.C.C.A.N. 1906, 2811.

Section 1031(f)(1) sets forth special rules for exchanges between related persons. Section 1031(f)(1) provides that if (1) a taxpayer exchanges property with a related person, (2) nonrecognition treatment applies to the taxpayer in accordance with § 1031 (without regard to § 1031(f)) with respect to the exchange, and (3) within two years of the date of the last transfer, either the taxpayer or the related person disposes of the property received in the exchange, then there is no nonrecognition of gain or loss in the exchange. In other words, the gain or loss that was deferred under § 1031 must be recognized as of the date of the dispositio n of the property received in the exchange.

Section 1031(f)(2) provides that certain dispositions will not be taken into account for purposes of § 1031(f)(1). These include any disposition (1) after the earlier of the death of the taxpayer or the death of the related person, (2) in a compulsory or involuntary conversion (within the meaning of § 1033) if the exchange occurred before the threat or imminence of such conversion, or (3) 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)(4) provides that § 1031 shall not apply to any exchange that is part of a transaction, or series of transactions, structured to avoid the purposes of § 1031(f). Thus, if a transaction is set up to avoid the restrictions of § 1031(f), § 1031(f)(4) operates to prevent nonrecognition of the gain or loss in the exchange.

Both the Ways and Means Committee Report and the Senate Finance Committee Print describe the policy concern that led to the enactment of § 1031(f):

Because a like-kind exchange results in the substitution of the basis of the exchanged property for the property rece ived, related parties have engaged in like-kind exchanges of high basis property fo r low basis property in anticipation of the sale of the low basis property in order to reduce or avoid the recognition of gain on the subsequent sale. Basis shifting also can be used to accelerate a loss on retained property. The committee believes that if a related party exchange is followed shortly thereafter by a disposition of

the property, the related parties have, in effect, `cashed out' of the in vestment, and the original exchange should not be accorded nonrecognition treatment. ....

Nonrecognition will not be accorded to any exchange which is part of a transaction or series of transactions st ructured to avoid the purposes of the related party rules. For example, if a taxpayer, pursuant to a prearranged plan, transfers property to an unrelated part y who then exchanges the property with a party related to the taxpayer within 2 years of the previous transfer in a transaction otherwise qualifying under section 1031, the related party will not be entitled to nonrecognition treatment under section 1031.

H.R. REP. NO. 101-247, at 1340-41 (1989), *reprinted in* 1989 U.S.C.C.A.N. 1906, 2810-11.

The Parking Transaction under Rev. Proc. 2000-37.

Rev. Proc. 2000-37 sets forth a safe harbor for acquiring replacement property under a QEAA, sometimes referred to as a "parking" transaction, to facilitate reverse like-kind exchanges. As provided in this safe harbor, the Service will not challenge either (1) the qualification of property as either replacement or relinquished property (as defined in § 1.1031(k)-1(a)), or (2) the treatment of the exchange accommodation titleholder as the beneficial owner of such property for Federal income tax purposes, if the property is held in a QEAA as defi ed in section 4.02 of Rev. Proc. 2000-37. n

APPLICATION AND ANALYSIS

In the present case, Related Party's disposal of Relinquished Property #1 and Relinquished Property #2 within two years of their acquisition will not trigger taxable gains pursuant to § 1031(f)(1). Taxpayer and Related Party did not exchange properties either directly or through QI. Ta xpayer transferred Relinquished Property #1 and Relinquished Property #2 to Related Party through QI, who also purchased Replacement Property #1 and Replacement Property #2 from unrelated parties for Taxpayer. Taxpayer's transfer of Relinquished Property #1 and Relinquished Property #2 to QI and subsequent receipt of like-kind Replacement Property #1 and Replacement Property #2 from QI is treated as an exchange with QI, who is not related to Taxpayer. Treas. Reg. § 1.1031(k)-1(g)(4).

In addition, § 1031(f)(4) will not apply to prevent nonrecognition of the gain or loss in the exchange. Taxpayer did not transfer Relinquished Property #1 and Relinquished Property #2 to Related Party as part of a transaction or series of transactions structured to avoid the purposes of § 1031(f)(1). The related parties in this case did not exchange high basis properties for low basis properties in anticipation of the sale of the low basis properties. Only Taxpayer held properties before the exchanges and continued its investments after the exchange. Related Party did not hold properties before the exchange and purchased Relinquished Property #1 and Relinquished Property #2 for cash. Accordingly, Related Party's proposed disposal of Relinquished Property #1 and Relinquished Property #2 within two years of the acquisitions will not result in a "cashing out" of any investments or shifting of bases between Taxpayer and Related Party.

RULING

Under the given facts and representations, § 1031(f) will not apply to trigger recognition of any gain realized when (1) Ta xpayer purchases Replacement Property #1 and

Replacement Property #2 from unrelated parties via EAT or QI, (2) Taxpayer sells Relinquished Property #1 and Relinquished Property #2 to Related Party for cash consideration received by QI, and (3) Relat ed Party disposes of Relinquished Property #1 and Relinquished Property #2 within two years of the acquisitions.

DISCLAIMERS

Except as provided above, no opinion is expressed as to the Federal tax treatment of the transaction under any other provisions of the Internal Revenue Code and the Income Tax Regulations that may be applicable or under any other general principles of Federal income taxation. Neither is any opinion expressed as to the tax treatment of any conditions existing at the time of, nor effects resulting from, the transaction that are not specifically covered by the above ruling.

This ruling assumes that (1) EAT is eligible to serve as exchange accommodation titleholder within the meaning of Rev. Proc. 2000-37, (2) QI is eligible to serve as qualified intermediary in this transaction within the meaning of , § 1.1031(k)- 1(g)(4), (3) Taxpayer and Related Party are related persons within the meaning of § 1031(f)(3), (4) the transactions satisfy the requirements for deferred exchanges set forth in § 1.1031(k)-1, and (5) the first transaction satisfies the safe harbor for reverse exchanges set forth in Rev. Proc. 2000-37. While this office has not verified any of the material submitted in support of the request for ruling, it is subject to verification on examination. No opinion is expressed as to whether the accommodators used in this transaction are disqualified persons as defin ed in § 1.1031(k)-1(k), as that would constitute essentially a factual determination.

This ruling is directed only to Taxpayer. Section 6110 (k)(3) provides that it may not be cited as precedent. Pursuant to the Po wer of Attorney submitted by Taxpayer, a copy of this letter will be sent to Taxpayer's authorized representatives.

Sincerely, _____

William A. Jackson

Branch Chief, Branch 5

Office of Associate Chief Counsel

(Income Tax and Accounting)