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LEGEND:

Trust = * * *

Operating Partnership = * * *

State X = * * *

Property A = * * *

Property B = * * *

Date 1 = * * *

Date 2 = * * *

Date 3 = * * *

a = * * *

Dear * * *

This responds to a letter dated November 22, 2006, submitted on behalf of Trust, requesting a ruling under § 857(b)(6)(D) of the Internal Revenue Code.

FACTS

Trust is a corporation organized in State X that elected to be taxed as a real estate investment trust (REIT) beginning with its taxable year ended Date 1. Trust directly and indirectly owns a percent of the interests in Operating Partnership, a limited partnership that is classified as a disregarded entity for federal income tax purposes. Trust conducts operations and owns properties, both directly and indirectly, through Operating Partnership and other entities.

On Date 3, Operating Partnership entered into a qualified intermediary "QI" arrangement. Pursuant to this QI arrangement, Operating Partnership exchanged certain timberlands (Property A) for other timberlands (Property B) as replacement property (the Exchange). Operating Partnership received no consideration other than Property B in the Exchange.

Trust has made the following representations: (1) Trust will treat the Exchange as an exchange described in § 1031(a) of the Code for federal income tax purposes; (2) no gain or loss was recognized in the Exchange as a result of the application of § 1031(a); and (3) the Exchange satisfied the requirements for deferred exchanges set forth in § 1.1031(k)-1 of the Income Tax Regulations.

LAW AND ANALYSIS

Section 857(b)(6)(A) of the Code imposes a 100 percent tax on a REIT's net income from prohibited transactions. Section 857(b)(6)(B)(iii) defines the term "prohibited transaction" as the sale or other disposition of property described in § 1221(a)(1) which is not foreclosure property. Section 1221(a)(1) describes "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business," sometimes referred to as "dealer property."

Section 857(b)(6)(C) of the Code provides a safe harbor for REITs that invest in real property for the production of rental income under which the term "prohibited transaction" does not include a sale of property that is a real estate asset if certain requirements are met. Section 857(b)(6)(C)(iii) sets forth one of these requirements. Section 857(b)(6)(C)(iii) provides that: "(I) during the taxable year the trust does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or (II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the assets of the trust as of the beginning of the taxable year."

Section 857(b)(6)(D) of the Code extends the safe harbor of § 857(b)(6)(C) to REITs that hold real estate assets used in connection with the trade or business of producing timber. Like § 857(b)(6)(C), § 857(b)(6)(D) provides that a "prohibited transaction" does not include a sale of property that is a real estate asset if certain requirements are met. Section 857(b)(6)(D) sets forth one of these requirements. Like § 857(b)(6)(C)(iii), § 857(b)(6)(D)(iv) provides that: "(I) during the taxable year the trust does not make more than 7 sales of property (other than sales of foreclosure property or sales to which section 1033 applies), or (II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than sales of foreclosure property or sales to which section 1033 applies) sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the assets of the trust as of the beginning of the taxable year."

Section 1031(a) of the Code generally provides that a taxpayer recognizes no gain or loss when it exchanges property held for productive use in a trade or business or for investment for property of a like kind that also is to be held for productive use or investment.

Section 1.1031(k)-1 of the Regulations provides rules for the application of § 1031 and the regulations promulgated thereunder in the case of a "deferred exchange." For purposes of § 1031, a deferred exchange generally is an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property").

In applying the safe harbor for prohibited transactions, § 857(b)(6)(D)(iv) of the Code limits on an annual basis the frequency of transactions that a REIT can enter into by reference to the number of "sales" of property and to the basis of property "sold." The legislative history underlying § 857(b)(6) indicates that Congress enacted the prohibited transactions tax to deter REITs from engaging in "ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development project." See S. Rep. No. 94-938, 94th Cong., 2d Sess. 470 (1976). The legislative history further indicates that Congress believed that "REITs should

have a safe harbor within which they can modify the portfolio of their assets without the possibility that a tax would be imposed equal to the entire amount of the appreciation in those assets" and that the restrictions on the availability of the safe harbor would "prevent REITs from using the safe harbor rule to permit them to engage in an active trade or business such as the development and subdivision of land." S. Rep. No. 95-1263, 95th Cong., 2d Sess. 178-79 (1978). Congress extended the safe harbor of § 857(b)(6)(C) to timber REITs by adding § 857(b)(6)(D). See H. Rep. 108-755, 108th Cong., 2d Sess. 321-325 (2004).

In the present case, Trust's participation in the Exchange appears to be consistent with the Congressional intent of allowing REITs to modify their portfolios without incurring a prohibitive tax. Moreover, Trust has represented that the Exchange satisfies the requirements for deferred exchanges set forth in § 1.1031(k)-1 of the Regulations and that no gain or loss was recognized on the Exchange as a result of the application of § 1031(a) of the Code. Accordingly, based on these representations, Property A should not be treated as having been "sold" for purposes of § 857(b)(6)(D)(iv).

CONCLUSION

Based solely on the information submitted and the representations made, we rule that the disposition of Property A as part of the Exchange will not be taken into account as a sale of property, and that Property A will not be treated as property sold, for purposes of applying § 857(b)(6)(D)(iv) of the Code to Trust's taxable year ended Date 2.

No opinion is expressed or implied with regard to whether Trust qualifies as a REIT under Subchapter M of the Code. In addition, no opinion is expressed or implied as to whether § 1031(a) of the Code applies to the Exchange.

This letter ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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,

Alice M. Bennett
Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions &
Products)

Enclosures:

Copy of this letter
Copy for section 6110 purposes

cc: * * *