

Private Letter Ruling 9851039, 12/18/1998, IRC Sec(s). 1031

UIL No. 1031.03-00; 1031.05-00

Headnote:

Reference(s): Code Sec. 1031;

The Service has ruled that the exchange of an agricultural conservation easement for a farm qualifies as a tax-free like-kind exchange under section 1031(a).

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Full Text:

Date: September 15, 1998

Refer Reply To: CC:DOM:IT&A:5 PLR-121870-97

LEGEND:

Taxpayers = ***

Trust A = ***

Trust B = ***

Trustee = ***

Blackacre = ***

Whiteacre = ***

Greenacre = ***

County C = ***

State D = ***

Q1 = ***

Law = ***

\$x = ***

Date E = ***

Date F = ***

Date G = ***

Date H = ***

Date I = ***

Date J = ***

Dear ***

This responds to your letter, dated November 3, 1997, requesting private letter rulings regarding the application of [L](#) section 1031 of the Internal Revenue Code to the transaction described herein. The facts of this transaction, as represented by Taxpayers, follow:

Taxpayers, Trust A and Trust B, are testamentary trusts. Trustee is the appointed trustee of both trusts. Taxpayers each separately own a farm in fee simple, both located in County C of State D. The farms constitute real property held for productive use in a trade or business or for investment within the meaning of [L](#) section 1031(a). Trust A owns Blackacre and Trust B owns Whiteacre.

Taxpayers sought to convey an agricultural conservation easement as to their farms to State D in exchange for property of like-kind. Under section 903 of the Law of State D, an agricultural conservation easement is an interest in land, less than fee simple, which interest represents the right to prevent the development or improvement of the land for any purpose other than agricultural production. The easement may be granted by the owner of the fee simple to any third party, to State D, to a county governing body or to a unit of local government. It may be granted for a term of 25 years or in perpetuity, as the equivalent of covenants running with the land.

Accordingly, on Date F, Trustee, acting on behalf of Taxpayers, entered into an agreement for the sale of an agricultural conservation easement in perpetuity, as to Blackacre and Whiteacre ("Sale Agreement"), to State D. The purchase price of the agricultural conservation easement is allocable between Trust A and Trust B on a relative fair market value basis.

Trustee also entered into an agreement dated Date E ("Purchase Agreement") to acquire a fee simple interest in a third farm with improvements ("Greenacre") as replacement property to be held by Taxpayers for productive use in a trade or business or for investment. Ownership of Greenacre is allocable between Taxpayers in accordance with the relative fair market values of the agricultural conservation easement that they granted as to Blackacre and Whiteacre.

On Date G, Trustee entered into an exchange agreement with Q1 to serve as a qualified intermediary for each trust. Q1 is a corporation owned by the members of the law firm that is submitting this ruling request. The president of Q1 is a member of that firm and is the taxpayer representative of both Trust A and Trust B as to this ruling request. The law firm has not performed any legal services for Trustee, Trust A or Trust B or the beneficiaries of the two trusts prior to the services which are being provided in connection with the like-kind exchange which is the subject of this ruling request. Further, the only

services provided by the law firm to Trustee or Taxpayers are services with respect to the exchange of the agricultural conservation easement which they intend to qualify under section 1031 of the Code. Q1 is not a disqualified person within the meaning of section 1.1031(k)-1(k) of the Income Tax Regulations.

Under the terms of the exchange agreement, by virtue of an "Assignment of Sale Agreement" dated Date G, Trustee assigned to Q1 the Taxpayers' interests in the Sale Agreement. All parties to the Sale Agreement were notified in writing of this assignment on Date H.

Also under the terms of the exchange agreement, by virtue of the "Assignment of Purchase Agreement" dated Date G, Trustee assigned to Q1 the Taxpayers' interests in the Purchase Agreement. All parties to the Purchase Agreement were notified in writing of this assignment on Date 1.

The exchange agreement expressly limits Taxpayers' rights to receive, pledge, borrow or otherwise obtain the benefits of money or other property held by Q1 until the exchange account is closed. The criteria for closing the exchange account are the same as the additional restrictions on safe harbors set forth at , , and section 1.1031(k)-1(g)(6)(i), (ii), and (iii) of the regulations.

On Date J, at settlement under the Sale Agreement pertaining to the agricultural conservation easement, Q1 caused the agricultural conservation easement (the relinquished property) to be conveyed directly to State D. The consideration for the sale of the relinquished property was paid by State D to Q1.

On Date J, at settlement under the Purchase Agreement, utilizing the proceeds received at settlement for the relinquished property, Q1 acquired Greenacre (the replacement property) and caused it to be deeded directly to Trustee (for Taxpayers) in exchange for the relinquished property. After the exchange, Taxpayers will hold the replacement property for productive use in a trade or business or for investment. The transfer of the relinquished property and the acquisition of the replacement property occurred on the same day, Date J.

Inasmuch as the purchase price of the replacement property exceeded by \$x the sales price of the relinquished agricultural conservation easement, prior to settlement for the replacement property, Q1 assigned an undivided percentage interest in the Purchase Agreement to the presumed beneficiaries of Trust B (the settlor's two sons), who provided the additional funds necessary to acquire the replacement property. They received an undivided interest in Greenacre which they hold as tenants in common with Taxpayers. The Taxpayers' interests in the replacement property at least equal the net proceeds from the conveyance of the relinquished property. Closing costs were shared by Taxpayers and the two sons in proportion to their interests.

Taxpayers request a ruling that the agricultural conservation easement on the farms is of like-kind with a fee simple interest in the replacement farm property and that the exchange of the agricultural conservation easement on the farms for a fee simple interest in such replacement property, as set forth in the represented facts, qualifies for nonrecognition of gain under section 1031(a) of the Code.

Section 1031(a)(1) of the Code provides that no gain or loss shall be recognized on the exchange of property 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(a)(3) of the Code provides that for purposes of this subsection, any property received by the taxpayer shall be treated as property which is not of like kind if — (A) such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (B) such property is received after the earlier of (i) the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (ii) the due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs.

The transaction satisfies these timing requirements for identification and receipt of replacement property because the transfer of the relinquished property and the receipt of the replacement property occurred on the same day, Date J.

Compliance with these timing rules does not assure Taxpayers of nonrecognition of gain from the transaction unless Taxpayers also avoid actual or constructive receipt of cash or other non-like-kind property. Section 1.1031(k)-1(f)(1) of the regulations provides, in part, that in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives like-kind replacement property. In that event, the transaction will constitute a sale and not a deferred exchange even though the taxpayer may ultimately receive like-kind replacement property.

In addition, actual or constructive receipt of money or other property by an agent of the taxpayer is actual or constructive receipt by the taxpayer. Section 1.1031(k)-1(f)(2) explains that except as provided in paragraph (g) of this section (relating to safe harbors), for purposes of section 1031, the determination of whether (or the extent to which) the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property, is made under the general rules concerning actual or constructive receipt and without regard to the taxpayer's method of accounting. The taxpayer is in actual receipt of money or property at the time the taxpayer actually receives the money or property or receives the economic benefit of the money or property. The taxpayer is in constructive receipt of money or property at the time the money or property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time or so that the taxpayer can draw upon it if notice of intention to draw is given. Although the taxpayer is not in constructive receipt of money or property if the taxpayer's control of its receipt is subject to substantial limitations or restrictions, the taxpayer is in constructive receipt of the money or property at the time the limitations or restrictions lapse, expire, or are waived. In addition, actual or constructive receipt of money or property by an agent of the taxpayer (determined without regard to paragraph (k) of this section) is actual or constructive receipt by the taxpayer.

If the taxpayer utilizes a qualified intermediary, the determination of whether the taxpayer is in constructive receipt is made as if the qualified intermediary is not an agent of the taxpayer. Section 1.1031(k)-1(g)(4)(i) of the regulations provides that in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for purposes of section 1031(a). Paragraph (g)(4)(ii) states that paragraph (g)(4)(i) applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the rights of the taxpayer to receive, pledge, borrow, or otherwise obtain the benefits of

money or other property held by the qualified intermediary as provided in paragraph (g)(6) of this section.

Section 1.1031(k)-1(g)(6)(i) provides that an agreement limits a taxpayer's rights as provided in this paragraph (g)(6) only if the agreement provides that the taxpayer has no rights, except as provided in paragraphs (g)(6)(ii) and (g)(6)(iii) of this section, to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period. Paragraph (g)(6)(ii) states that the agreement may provide that if the taxpayer has not identified replacement property before the end of the identification period, the taxpayer may have rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property at any time after the end of the identification period. Paragraph (g)(6)(iii)(A) states that the agreement may provide that if the taxpayer has identified replacement property, the taxpayer may have rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property after the receipt by the taxpayer of all the replacement property to which the taxpayer is entitled under the Exchange Agreement.

Section 1.1031(k)-1(g)(4)(iii) of the regulations states, in part, that a qualified intermediary is a person who is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and enters into a written agreement with the taxpayer (the "exchange agreement") and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer. Section 1.1031(k)-1(k) defines the term disqualified person, in part, as a person who has acted as the taxpayer's attorney within the 2-year period ending on the date of the transfer of the first of the relinquished properties. However, for purposes of this definition, performance of services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under section 1031 will not be taken into account.

Section 1.1031(k)-1(g)(4)(iv) of the regulations provides that regardless of whether an intermediary acquires and transfers property under general tax principles, solely for purposes of paragraph (g)(4)(iii) of this section —

- (A) An intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property,
- (B) An intermediary is treated as acquiring and transferring the relinquished property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than the taxpayer for the transfer of the relinquished property, to that person and, pursuant to that agreement, the relinquished property is transferred to that person, and
- (C) An intermediary is treated as acquiring and transferring the replacement property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to the taxpayer.

Section 1.1031(k)-1(g)(4)(v) of the regulations provides that solely for purposes of paragraphs (g)(4)(iii) and (iv) of this section, an intermediary is treated as entering into an agreement if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are notified in writing on or before the date of the relevant transfer of the property. For example, if a taxpayer enters into an agreement for the transfer of relinquished property and thereafter assigns its rights in that agreement to an intermediary, and all parties to that agreement are notified in writing of the

assignment on or before the date of the transfer of the relinquished property, the intermediary is treated as entering into that agreement. If the relinquished property is transferred pursuant that agreement, the intermediary is treated as having acquired and transferred the relinquished property.

In the present case, Taxpayers entered into an exchange agreement with Q1. Pursuant to the exchange agreement, the Assignment of Sale Agreement, and the Assignment of Purchase Agreement, Taxpayers assigned all of their rights under the Sale Agreement and the Purchase Agreement to Q1. Timely written notice of these assignments was given to all parties to these agreements. Pursuant to the exchange agreement and the assignments, Q1 received the sales proceeds from State D for the relinquished property (the easement), and applied these proceeds to the purchase of the replacement property (Greenacre). Pursuant to the exchange agreement, Q1 had sole and exclusive possession, dominion, control and use of the funds until they were expended to purchase and transfer the replacement property to Taxpayers.

Taxpayers represent that Q1 qualifies under section 1.1031(k)-1(g)(4) of the regulations as a "qualified intermediary." Although we make no determination whether Q1 is a qualified intermediary, none of the facts provided by Taxpayers indicate otherwise. We will therefore assume for purposes of this analysis that Q1 is a qualified intermediary. Accordingly, Q1 is not an agent of Taxpayers and the exchange funds received by Q1 are not deemed received by Taxpayers.

Section 1.1031(a)-1(b) of the regulations provides, in part, that as used in 1031(a) the words "like kind" have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under that section be exchanged for property of a different kind or class. The fact that any real estate involved is improved or unimproved is not material, for that fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than a dealer for future use or realization of the increment in value is held for investment and not primarily for sale.

Section 1.1031(a)-1(c) of the regulations provides that no gain or loss is recognized if (1) a taxpayer exchanges property held for productive use in his trade or business, together with cash, for other property of like kind for the same use, such as a truck for a new truck or a passenger automobile for a new passenger automobile to be used for like purpose; or (2) a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or exchanges a leasehold of a fee with 30 years or more to run for real estate, or exchanges improved real estate for unimproved real estate; or (3) a taxpayer exchanges investment property and cash for investment property of a like kind.

Rev. Rul. 55-749, 1955-2 C.B. 295, holds that where, under applicable state law, water rights are considered real property rights, the exchange of water rights in perpetuity for a fee interest in land constitutes a nontaxable exchange of property of like kind within the meaning of section 1031(a) of the Code.

Rev. Rul. 68-331, 1968-1 C.B. 352, holds that the exchange of a leasehold interest in a producing oil lease, extending until the exhaustion of the deposit, for a fee interest in improved ranch land is an exchange of property for property of like kind under section 1031(a) of the Code.

Rev. Rul. 72-549, 1972-2 C.B. 472, holds that an easement and right-of-way granted to an electric power company is of a "like kind" with real property with nominal

improvements and real property improved with an apartment building under section 1031(a) of the Code.

Accordingly, based on your representations and the above analysis, and assuming that Q1 is a qualified intermediary, we rule as follows:

- (1) The agricultural conservation easement on Blackacre and Whiteacre is of like kind to the fee interests to be acquired by Taxpayers as tenants-in-common in Greenacre.
- (2) The transaction described in this letter qualifies as an exchange for which, under section 1031(a) of the Code, Taxpayers will recognize no gain or loss.

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of the transaction under other provisions of the Code and the Income Tax Regulations that may be applicable. No opinion is expressed as to the tax treatment of any conditions existing at the time of or effects resulting from the transaction that are not specifically covered by the above ruling.

Pursuant to the powers of attorney on file in this office, executed by Taxpayers on November 19, 1997, we are sending the original rulings to Taxpayers and copies of the ruling letters to the representative listed on the form. This ruling is directed only to the taxpayer(s) who requested it. Section 6110(j)(3) of the Code provides that it may not be cited as precedent.

Sincerely yours,

Assistant Chief Counsel

(Income Tax & Accounting)

by: Kelly E. Alton

Senior Technician Reviewer

Branch 5