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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
CC:DOM:IT&A:5-PLR-109811-99
Date:
February 10, 2000

Taxpayer:

Taxpayer's EIN:

Taxpayer's Address:

Legend

A =
B =
C =
D =
E =
F =
Taxpayers =

State M =
R =
S =
T =
Corporation =
x =
y =
z =
Year 1 =
Year 2 =

Dear :

This letter is in response to the request for a private letter ruling dated May 24, 1999, regarding issues under §§ 1031, 761, and 752 of the Internal Revenue Code. The facts regarding the transaction in question are as follows:

Taxpayers in this ruling request are six State M limited partnerships: A, B, C, D, E, and F. The partnerships all have the same general and limited partners. The limited partners, R, S, and T, each own an x interest in A, C, D, E, and F, and a y interest in B. The general partner in the partnerships is Corporation, a State M business corporation. Corporation owns a y interest in A, C, D, E, and F, and a z interest in B.

The properties owned by the partnerships are mobile home parks, which are real properties improved with the following items:

A: 173 concrete pads for mobile home sites;
B: 171 pads for mobile home sites, a single family dwelling which is rented to third parties, a barn, and four additional concrete block structures, three of which are leased for the operation of businesses serving the park and the general public, and one is a laundry facility which serves the park residents;
C: 131 pads for mobile home sites;
D: 140 pads for mobile home sites;
E: 103 pads for mobile home sites, and a well and sewage treatment plant, which provide water and sewerage disposal for the mobile home sites, and a storage rental facility;
F: 78 mobile home pads and a single family dwelling which is rented to third parties.

Taxpayers also represent that personal property associated with the mobile home parks will be traded in the exchange transactions.

Taxpayers plan to enter into an exchange agreement with a "Qualified Intermediary," in which the above-listed relinquished properties will be transferred to the Qualified Intermediary, who will sell the relinquished properties and hold the proceeds ("exchange funds"). Taxpayers' rights to the proceeds will be limited to the circumstances specified in § 1.1031(k)-1(g)(6) of the Income Tax Regulations. Taxpayers will then select replacement properties, which the Qualified Intermediary will purchase within the required statutory period, and then transfer to the Taxpayers.

Taxpayers have indicated that the as-yet unidentified replacement properties will likely consist of apartment complexes, and each partnership will own an undivided interest in the replacement properties as tenants in common with the other partnerships. To the extent that the replacement properties require some management in order to generate a rental income stream, Corporation will manage the properties, furnishing only those services which are customary in connection with the rental, maintenance and repair of the properties.

The relinquished properties are all subject to mortgages for amounts borrowed by the partnerships. In July, Year 1, Taxpayers refinanced the mortgages to take advantage of lower interest rates, and some of the proceeds of the refinancing were distributed to the partners, who purchased more properties. It is represented that Taxpayers did not contemplate the exchanges at the time of the refinancing; Taxpayers were first approached concerning the exchange transactions in February, Year 2. It is further represented that the aggregate amount of mortgages on the replacement properties (the "Debt Amount") will be greater than or equal to the refinanced mortgages on the relinquished properties.

It is anticipated that the lenders making the mortgages for the purchase of the replacement properties will require that all of the partnerships be jointly and severally liable for those mortgages. The partnerships will enter into a debt-sharing agreement which will (i) allocate the risk of loss among the partnerships so as to ensure that the amount of each partnership's debt is not reduced by the exchange, (ii) obligate each of the partnerships to make sure its proportional share of payments on the loans is secured by the replacement properties, and (iii) obligate each of the partnerships to indemnify the other partnerships against any failure to make such payments.

Rulings Requested

1. The exchange of the relinquished properties for the replacement properties through the use of a qualified intermediary will not result in the constructive receipt of the exchange funds by the partnerships.

2. The exchange of the mobile home parks currently owned by the partnerships for undivided interests in other income-producing property as tenants in common will be an exchange of property of a like kind or class.

3. The proceeds of the refinancing of the partnerships' debts in Year 1 will not be considered as payments of boot in the exchange transactions.

4. The exchange of the relinquished properties for the replacement properties will be an exchange of property for which, under § 1031(a) of the Code, the partnerships will recognize no gain or loss, except to the extent that the exchange funds together with the Debt Amount, exceed the purchase price of the replacement properties; and except to the extent that the value of any personal property included with the relinquished property exceeds the value of all personal property included with the replacement property.

5. The ownership of the replacement properties by the partnerships as tenants in common after the completion of the exchanges will not result in the formation of a partnership among the partnerships with respect to the ownership and operation of the replacement properties.

6. The joint and several obligation of the partnerships to repay the Debt Amount will not result in a reduction in any partner’s share of partnership debt.

Law and Analysis

Rulings 1, 2, 3, and 4

Section 1.1031(a)-1(a) of the regulations provides, in part, that no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged solely for property of a like kind to be held either for productive use in a trade or business or for investment.

Section 1.1031(a)-1(b) provides, in part, that as used in § 1031(a) of the Code, 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 future realization of the increment in value is held for investment and not primarily for sale.

Section 1.1031(a)-1(c) 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 a 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.

Section 1.1031(a)-2(b) provides that depreciable tangible personal property is exchanged for property of a “like kind” under § 1031 if the property is exchanged for property of a like kind or like class. Depreciable tangible personal property is of a like kind or class to other depreciable tangible personal property if the exchanged properties are either within the same General Asset Class or within the same Product Class.

Section 1.1031(j)-1(a) provides, in part, that as a general rule, the application of § 1031 requires a property-by-property comparison for computing the gain recognized and basis of property received in a like -kind exchange. This section provides an exception to this general rule in the case of an exchange of multiple properties. An exchange is an exchange of multiple properties if, under paragraph (b)(2) of this section, more than one exchange group is created. In addition, an exchange is an exchange of multiple properties if only one exchange group is created but there is more than one property being transferred or received within that exchange group.

Section 1.1031(k)-1(a) provides that a deferred exchange 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").

Section 1.1031(k)-1(f)(1) 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.

Section 1.1031(k)-1(g)(4)(i) provides that when a deferred exchange involves a qualified intermediary, the qualified intermediary is not considered an agent of the taxpayer for purposes of § 1031(a) of the Code. Thus, the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer. Section 1.1031(k)-1(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 § 1.1031(k)-1(g)(6).

Section 1.1031(k)-1(g)(4)(iii) provides 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.

In Garcia v. Commissioner, 80 T.C. 491 (1983), the owners of the replacement property were required to obtain another mortgage on the property, which had the effect of "evening up" the liabilities on both sides of the exchange. The court found that the taxpayers' assumption of this liability as part of the exchange transaction had independent economic significance aside from tax avoidance and, therefore, no boot was recognized by the taxpayers.

The taxpayer in Fredericks v. Commissioner, T.C. Memo. 1994-27, refinanced his mortgage after the exchange agreement was entered into, but before the properties were actually exchanged. Although the taxpayer received cash from the refinancing, the court held that the receipt of such cash was not considered boot because the taxpayer had reasons for refinancing that were unrelated to the exchange, namely, to obtain a lower interest rate and the fact that the original loan was due shortly.

Taxpayers represent that the relinquished properties are held for investment purposes, and are being exchanged for tenancy-in-common interests in apartment complexes, which will also be held for investment purposes. Rev. Rul. 73-476, 1973-2 C.B. 300, holds that the exchange of tenancy-in-common interests in real property for a fee simple interest in real property is an exchange of property of a like kind under § 1031(a). Accordingly, we conclude that the relinquished real properties are of a like kind to the proposed replacement properties for purposes of § 1031.

To the extent that the partnerships transfer personal property as part of the relinquished property, there will be an exchange of multiple properties under § 1.1031(j)-1. The partnerships should calculate the gain or loss attributable to the exchange of the personal property in accordance with the provisions of those regulations.

In the present case, Taxpayers propose to enter into a deferred exchange. Taxpayers represent that the exchange transactions will be accomplished through the use of a qualified intermediary as defined in § 1.1031(k)-1(g)(4). Taxpayers represent that after entering into the purchase agreement with the buyer of the relinquished properties, they will transfer their rights under the purchase agreement to the qualified intermediary, thereby giving the qualified intermediary the legal title and power to transfer the relinquished properties. Once the qualified intermediary sells the relinquished property and receives the proceeds, those proceeds will be held by the qualified intermediary, and Taxpayers' rights to receive, pledge, borrow, or otherwise obtain the benefits of the proceeds will be limited to those situations specified in § 1.1031(k)-1(g)(6). Accordingly, the transaction will qualify as a deferred exchange rather than a sale of the properties.

The refinancing issue in the present case is similar to Fredericks, supra, because the refinancing in Year 1 had an economic significance that is independent from the proposed exchange. Taxpayers received lower interest rates on their loans, and the proceeds from the refinancing were used by the partners to purchase more properties. Accordingly, the proceeds of the Year 1 refinancing will not be considered as payments of boot in the exchange transaction.

Rulings 5 and 6

Section 761(a) provides that the term “partnership” includes a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not a corporation or a trust or estate.

Section 1.761-1 provides, in part, that the term “partnership” is broader in scope than the common law meaning of partnership and may include groups not commonly called partnerships. See § 7701(a)(2). The regulation also provides that mere coownership of property that is maintained, kept in repair, and rented or leased does not constitute a partnership. Tenants in common may be partners if they actively carry on a trade, business, financial operation, or venture and divide the profits thereof. The furnishing of customary services in connection with the maintenance and repair of the apartments will not render a coownership a partnership. However, the furnishing of additional services will render a coownership a partnership if the additional services are furnished directly by the coowners or through their agent.

In Rev. Rul. 75-374, 1975-2 C.B. 261, two parties each owned an undivided one-half interest in an apartment project. A management company retained by the co-owners managed the building. Customary tenant services such as heat and water, unattended parking, trash removal, normal repairs, and cleaning of public areas were furnished at no additional charge. Additional services, such as attendant parking, cabanas, and gas and electricity were provided by the management company for a separate charge. The ruling holds that the furnishing of customary services in connection with the maintenance and repair of an apartment project will not render a co-ownership a partnership. The furnishing of additional services by the owners or through an agent will render a co-ownership a partnership. The revenue ruling concludes that since the management company is not an agent of the owners and the owners did not share the income earned from the additional services, the owners were not furnishing services. Therefore, the owners are to be treated as co-owners and not partners under § 761.

Section 752(a) provides that any increase in a partner’s share of the liabilities of a partnership, or any increase in a partner’s individual liabilities by reason of the assumption by the partner of the liabilities, is considered a contribution of money by that partner to the partnership.

Section 752(b) provides that any decrease in a partner’s share of the liabilities of a partnership, or any decrease in a partner’s individual liabilities by reason of the assumption by the partnership of such individual liabilities, shall be considered a distribution of money to that partner by the partnership.

Taxpayers represent that to the extent the replacement properties need to be managed, they will be managed by Corporation. In managing any of the properties, Corporation will only provide those services which are usual and customary to maintain the replacement properties, such as heat, air conditioning, hot and cold water, unattended parking, normal repairs, cleaning of public areas, and trash removal, and will not render additional services. Based upon such representations, we conclude that the partnerships' ownership and operation of the replacement properties as tenants in common will not be treated as a partnership or as an association taxable as a corporation for federal income tax purposes.

With respect to the repayment of the Debt Amount, Taxpayers represent that the indebtedness outstanding with respect to each partnership before the § 1031 exchange is considered recourse indebtedness (within the meaning of § 1.752-2) with respect to the partnership. The partnerships will enter into a debt agreement whereby each partnership will be liable for its proportionate share of payments on the mortgage and will be indemnified by the other partnerships to the extent that it pays more than its proportionate share.

Further, Taxpayers represent that each partnership's portion of the debt will obligate the partnership in an amount at least equal to the amount of liabilities for which the partnership was liable before the exchange and acquisition of the replacement properties. Accordingly, we also conclude that the joint and several obligation of the partnerships to repay the Debt Amount will not result in a reduction in any partner's share of partnership debt.

Conclusions

Based upon Taxpayers' representations and the above analysis, we rule as follows:

1. The exchange of the relinquished properties for the replacement properties through the use of a qualified intermediary will not result in the constructive receipt of the exchange funds by the partnerships.

2. The exchange of the fee simple interests in the real and personal property comprising the mobile home parks to be relinquished by the partnerships for undivided interests in other real and personal property represented to be of a like kind or class to be held as tenants in common will qualify as a like-kind exchange under § 1031.

3. The proceeds of the refinancing of the partnerships' debts in Year 1 will not be considered as payments of boot in the exchange transactions.

4. The exchange of the relinquished properties for the replacement properties will be an exchange of property for which, under § 1031(a), the partnerships will recognize no gain or loss, except to the extent that the sum of the proceeds from the relinquished properties and the Debt Amount exceeds the purchase price of the replacement properties, and except as provided in § 1.1031(j)-1.

5. The ownership of the replacement properties by the partnerships as tenants in common after the completion of the exchanges will not result in the formation of a partnership among the partnerships with respect to the ownership and operation of the replacement properties.

6. The joint and several obligation of the partnerships to repay the Debt Amount will not result in a reduction in any partner's share of partnership debt.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code 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.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Income Tax and Accounting)

By:______________________________
Douglas A. Fahey
Assistant to the Chief, Branch 5