Internal Revenue Service

Number: **201048025**
Release Date: 12/3/2010

Index Number: 1031.05-00

Department of the Treasury
Washington, DC 20224

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B05
PLR-117961-10

Date:
August 25, 2010

TY:

Legend

Taxpayer =

State A =
Partnership =

Related Party =

State B =
TP Relinquished Property =
Buyer =
Date 1 =
$a =
$b =
$c =
$d =
$e =
QI =
Date 2 =
Date 3 =
x% =

Dear :

This is in response to a request for a private letter ruling dated April 23, 2010, submitted on your behalf by your authorized representatives. You have requested rulings concerning the application of § 1031(f) of the Internal Revenue Code (“Code”) to the transaction described below.

FACTS

Taxpayer is a State A corporation that has elected to be taxed as a real estate investment trust ("REIT"). Taxpayer uses an annual accounting period ending on December 31 and uses the overall accrual method of accounting for maintaining its accounting books and records and for filing its Federal income tax returns.

Taxpayer directly and indirectly owns 100 percent of the partnership interests in Partnership, a State A limited partnership disregarded as an entity separate from Taxpayer since Taxpayer is its sole owner. Taxpayer owns and operates a number of commercial real estate properties, primarily through Partnership and various disregarded entities wholly owned by Partnership.

Taxpayer is an affiliate of, and under the rules of § 267(b) is related to, Related Party, a publicly held statutory real estate investment trust organized in State B that elected to be taxed as a REIT.

A. Taxpayer's Exchange

Partnership owned TP Relinquished Property that was groundleased to Buyer, a party unrelated to Taxpayer and Related Party. Effective Date 1, Partnership entered into the TP Relinquished Property Sale Agreement to sell TP Relinquished Property to Buyer for a gross sale price of $a. TP Relinquished Property Sale Agreement includes the right for Partnership to assign its rights under the contract to a qualified intermediary and to otherwise convert the sale into a like-kind exchange under § 1031 of the Code.

Partnership entered into a Deferred Exchange Agreement with QI, acting as a qualified intermediary pursuant to Treas. Reg. § 1.1031(k)-1(g)(4), providing for the exchange of TP Relinquished Property. The Deferred Exchange Agreement provided that QI would comply with applicable deferred exchange regulations. Partnership and QI also entered into a Qualified Exchange Trust Agreement under Treas. Reg. § 1.1031(k)-1(g)(3) pursuant to which QI would hold the net TP Relinquished Property sales proceeds. Partnership assigned to QI its rights to receive the sales proceeds attributable to the disposition of TP Relinquished Property.

On Date 2, Partnership conveyed the TP Relinquished Property to Buyer by direct deed. The aggregate purchase price under the TP Relinquished Property Sale Agreement was $a, which consists of $b in cash and $c of unamortized prepaid rent, which your submission considers treated for purposes of § 1031(b) as a liability assumed by Buyer under Treas. Reg. §1.467-7(e)(2)(iii). The closing agent used a small amount of the cash for closing costs and transmitted the balance of the cash, $d, directly to QI pursuant to the Qualified Exchange Trust Agreement.

On Date 3, which was within 45 days after the sale of the TP Relinquished Property, Partnership identified certain Potential TP Replacement Properties for replacement and completion of the deferred exchange. Your submission estimates the value of the Potential TP Replacement Properties as $e, which is less than 200 percent of the gross sales price of TP Relinquished Property. A number of TP Replacement Properties are owned by Related Party or disregarded LLCs 100 percent owned by Related Party.

Partnership and Related Entity will enter into Related Party Sale Agreement pursuant to which Related Party agrees to sell some or all of the Potential TP Replacement Properties that it owns to Partnership, such that Partnership will reinvest at least $a, an amount equal to the gross proceeds realized from the transfer of the TP Relinquished Property less the costs of sale. The Related Party Sale Agreement will include the right for Related Party to assign its rights under the contract to a qualified intermediary and to otherwise convert the sale into a § 1031 like-kind exchange.

Your submission represents that within 180 days from the date of conveyance of the TP Relinquished Property, Partnership intends to complete its exchange by causing QI to acquire and transfer to Partnership a sufficient number of Potential TP Replacement Properties to reinvest an amount not less than the gross realized proceeds derived from disposition of the TP Relinquished Property less exchange costs and expenses of sale (the “Final TP Replacement Properties”). Title to the Final TP Replacement Properties may be conveyed to Partnership by deed directly from Related Party or by Related Party’s assignment of 100 percent of the membership interests in one or more limited liability companies holding title to one or more of the Final TP Replacement Properties where Related Party owns 100 percent of such a company prior to conveyance.

Your submission represents that Partnership will hold the properties received in its exchange for at least two years following the date of acquisition of such properties.

B. Related Party’s Exchange

According to the submission, Related Party will enter into a Deferred Exchange Agreement with an unrelated party acting as a qualified intermediary under Treas. Reg. § 1.1031(k)-1(g)(4), which will provide for Related Party’s exchange of those Potential TP Replacement Properties that it transfers to Partnership (“Related Party Relinquished Properties”). This agreement will provide that the qualified intermediary will comply with applicable deferred exchange regulations. Related Party and the qualified intermediary may enter into a Qualified Exchange Trust Agreement, in a form consistent with Treas. Reg. § 1.1031(k)-1(g)(3), providing a vehicle for the qualified intermediary to hold the proceeds from the sale of the Related Party Relinquished Properties. Related Party will then assign to this qualified intermediary its rights to receive the sales proceeds attributable to the Related Party Relinquished Properties.

At the closing of the transfer of the Related Party Relinquished Properties to Partnership, the closing agent will receive and transfer to Related Party's qualified intermediary all proceeds due Related Party, after payment of closing costs and expenses.

On or before the day that is 45 days after the transfer of the Related Party Relinquished Properties to Partnership, Related Party intends to identify replacement properties ("Potential Related Party Replacement Properties") that are like-kind to the Related Party Relinquished Properties in order to complete its own deferred like-kind exchange with respect to the Related Party Relinquished Properties. The Potential Related Party Replacement Properties may include properties owned by third parties and properties owned by parties affiliated with or related to Related Party, including but not limited to Taxpayer, under the rules of §§ 267(b) or 707(b) (each an "Affiliate"). The estimated value of the Potential Related Party Replacement Properties identified will be less than 200 percent of the gross sales price of the Related Party Relinquished Properties.

Related Party intends to reinvest an amount equal to the total sale price of the Related Party Relinquished Properties less exchange costs. In the event that Related Party acquires replacement properties having a value less than 100 percent of the value of the Related Party Relinquished Properties, the difference will result in the Related Party recognizing gain arising from the exchange in the full amount of such difference, but the amount of gain so recognized will not exceed x% of the gain realized by Related Party on its transfer of the Related Party Relinquished Properties.

Related Party will acquire ownership of some or all of the Potential Related Party Replacement Properties ("Final Related Party Replacement Properties") within 180 days from the transfer of the Related Party Relinquished Properties to Partnership. Related Party will enter into purchase agreements with the owner(s) of the Final Related Party Replacement Properties to purchase these properties. Related Party will assign its rights under each of the respective purchase agreements to its own qualified intermediary, who will disburse funds held by it from the proceeds of the sale of the Related Party Relinquished Properties plus funds supplied by or on behalf of Related Party to acquire the Final Related Party Replacement Properties. As with the Related Party Relinquished Properties, title to the properties may be transferred directly from the respective owner(s) of the Final Related Party Replacement Properties to Related Party by deed or by transfer of 100 percent membership interests in a limited liability company holding title.

The submission represents that Related Party will hold the Final Related Party Replacement Properties received in the exchange for at least two years following the date of acquisition of such properties.

C. Affiliate Exchange(s)

According to your submission, to the extent any of the Final Related Party Replacement Properties is owned by an Affiliate, prior to transfer of such property to Related Party, that Affiliate will enter into a Deferred Exchange Agreement with an unrelated party acting as a qualified intermediary under Treas. Reg. § 1.1031(k)-1(g)(4) providing for the Affiliate's exchange of those Final Related Party Replacement Properties that it transfers to Related Party (each, an "Affiliate Relinquished Property" and collectively the "Affiliate Relinquished Properties"). Each Deferred Exchange Agreement entered into by an Affiliate will provide that the qualified intermediary will comply with the applicable deferred exchange regulations. The qualified intermediary and each Affiliate transferring an Affiliate Relinquished Property may also enter into a Qualified Exchange Trust Agreement, in a form comparable to the agreement between Partnership and QI and consistent with Treas. Reg. § 1.1031(k)-1(g)(3), providing a vehicle for the qualified intermediary to hold the proceeds from the sale of the respective Affiliate Relinquished Property.

Each Affiliate entering into a Deferred Exchange Agreement will then assign to its qualified intermediary it rights to receive the sale proceeds attributable to its respective Affiliate Relinquished Property. At the closing of the transfer of any Affiliate Relinquished Property to Related Party, the closing agent will receive and transfer to the transferring Affiliate's qualified intermediary all proceeds due to that Affiliate, after payment of closing costs and expenses.

On or before the 45th day following the transfer of an Affiliate Relinquished Property to Related Party, the transferring Affiliate will identify replacement properties (collectively, the "Potential Affiliate Replacement Properties") for completion of a deferred like-kind exchange with respect to the sale of the Affiliate Relinquished Properties transferred by that Affiliate. All Potential Affiliate Replacement Properties will be owned by third parties unrelated to Taxpayer, Related Party or the transferring Affiliate.

Each transferring Affiliate will enter into purchase agreements with the third party sellers of some or all of the Potential Affiliate Replacement Properties and each such Affiliate will assign its rights under the purchase agreements to its qualified intermediary. At closing, the qualified intermediary will disburse funds to acquire the respective Affiliate Replacement Properties under the purchase agreements. Each respective Affiliate may deposit or cause to be deposited additional funds with respect to the closing of such acquisitions. Title to the properties may be transferred directly from the third party sellers to an Affiliate. Each transferring Affiliate will acquire ownership of some or all of the Potential Affiliate Replacement Properties within 180 days from the transfer of the Affiliate's respective Affiliate Relinquished Property or Affiliate Relinquished Properties.

To fully defer gain realized on the transfer of the Affiliate Relinquished Properties, each Affiliate would intend to reinvest an amount equal to the total sale price of the respective Affiliate Relinquished Properties less exchange costs. In the event that any Affiliate acquires replacement properties having a value less than 100 percent of the value of

the applicable Affiliate Relinquished Properties, the difference will result in that Affiliate recognizing gain arising from the exchange in the full amount of such difference, but the amount of gain so recognized will not exceed x% of the gain realized by the Affiliate on its transfer of the Affiliate Relinquished Properties.

Any Affiliate undertaking an exchange will hold the properties received in its exchange for at least two years following the date the acquisition of such properties.

Taxpayer expressly represents that each of the above Exchanges undertaken by Partnership, Related Party and any Affiliate will satisfy the requirements for deferred and reverse exchanges set forth in either or both Treas. Reg. §1.1031(k)-1 and Revenue Procedure 2000-37, 2000-2 C.B. 308.

REQUESTED RULINGS

You have requested the following two rulings:

1. Section 1031(f)(1) does not make the benefits of § 1031(a) unavailable to the Taxpayer under the facts and circumstances set forth above.

2. Receipt by Related Party or any transferring Affiliate of boot in its exchange that constitutes no more than x% of the total gain realized in the exchanges and that results in recognition of gain in an equal amount will not cause § 1031(f) to make the benefits of § 1031(a) unavailable to Taxpayer in its exchange.

LAW & ANALYSIS

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(b) provides, in part, that if an exchange would be within the provisions of subsection (a) if it were not for the fact that the property received in exchange consists not only of property permitted to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

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) (the second disposition) occurs.

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

In the present case, § 1031(f)(1) is not applicable to Taxpayer's exchange of TP Relinquished Property for the Final TP Replacement Properties because Taxpayer is exchanging property with QI, who is not a related person and qualifies as a third party pursuant to Treas. Reg. § 1.1031(g)(4). However, § 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). Both the House Ways and Means Committee Report and the Senate Finance Committee Print describe the policy concern that led to enactment of this provision:

Because a like-kind exchange results in the substitution of the basis of the exchanged property for the property received, related parties have engaged in like-kind exchanges of high basis property for 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 the 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 investment, and the original exchange should not be accorded nonrecognition treatment.

H.R. Rep. No. 247, 101st Cong. 1st Sess. 1340 (1989); S. Print. No. 56, at 151. The committee reports contain the following example of when § 1031(f)(4) applies:

If a taxpayer, pursuant to a re-arranged plan, transfers property to an unrelated party 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. 247, at 1341; S. Print. No. 56, at 152.

The Senate Finance Committee also gave three examples of its intent with respect to the non-tax avoidance exception at § 1031(f)(2)(C):

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 the entire interest in a single property or a larger undivided interest in any of such properties; (ii) dispositions of property in nonrecognition transactions; and (iii) transactions that do not involve the shifting of basis between properties.

S. Print. No. 56, at 152.

In Rev. Rul. 2002-83, 2002-2 C.B. 927, the taxpayer transferred low-basis property to an unrelated buyer through a qualified intermediary and acquired high basis replacement property from a related party, through the intermediary with the proceeds of the sale of the first property. In analyzing these facts under § 1031(f)(4), the Service quoted the above legislative history for the proposition that § 1031(f)(4) is intended to apply to situations in which related parties effectuate like-kind exchanges of high basis property for low basis property in anticipation of the sale of the low basis property. In such a case, the original exchange would not be accorded nonrecognition treatment. Under the facts in the revenue ruling, the taxpayer and the related party were attempting to sell the relinquished property to an unrelated party while using the substituted basis rule of § 1031(d) to reduce gain on the sale to $0. This allowed the parties to cash out of their investment in the relinquished property without recognizing gain. The Service concluded that the transaction was structured to avoid the purposes of § 1031(f)(1) and, therefore, taxpayer, as the first transferor, recognized all the gain realized on its transfer of the relinquished property.

As mentioned above, pursuant to § 1031(f)(2)(C), any second disposition by exchanging parties will not be taken into account for purposes of § 1031(f)(1) if it can be established to the satisfaction of the Secretary that neither the initial exchange nor the second disposition had as one of its principal purposes the avoidance of federal income tax. In that regard, "the non-tax avoidance exception generally will apply to . . . dispositions in nonrecognition transactions . . . ." H.R. Report No. 386, 101st Cong., 1st Sess. 614 (1989).[1]

[1] This is the language of the Conference Committee Report which adopted the Senate Amendment, quoting from the Senate Finance Committee Print, S. Print No. 56, at 152.

In the present case, the only transactions planned by the parties after Taxpayer receives the Final TP Replacement Properties as its replacement property are the subsequent acquisitions by Related Party of Related Party's replacement property and by any transferring Affiliate of that Affiliate's replacement property from unrelated third party sellers in subsequent exchanges under § 1031 nonrecognition transactions. Because both Related Party and any transferring Affiliate would also structure its disposition of property as an exchange for like-kind replacement property, neither § 1031(f)(4) nor Rev. Rul. 2002-83 applies. Taxpayer's exchange, Related Party's exchange and the potential Affiliate exchanges are or will be structured as like-kind exchanges qualifying under § 1031. There is no material "cashing out" of any party's investment in real estate. Upon completion of the series of transactions, all related parties will own property that is like-kind to the properties they exchanged. Moreover, none of the parties will have ever been in receipt of cash or other non-like-kind property (other than a limited amount of boot received in the exchange) in return for the relinquished properties.

Finally, any receipt of cash or other non-like-kind property by Related Party or any Affiliate from its qualified intermediary will be in a de minimis amount not greater than x% of the exchanging entity's realized gain. Such a de minimis amount is insufficient to support the conclusion, required by § 1031(f)(4) that the exchanges by Taxpayer, Related Party and Affiliates are undertaken to avoid the purposes of § 1031(f).

RULINGS

1. Section 1031(f) will not make the benefits of § 1031(a) unavailable to the Taxpayer under the facts and circumstances set forth above provided that Taxpayer, Related Party, and any Affiliate undertaking an exchange hold their respective replacement property(s) for two years following their respective acquisitions of replacement property(s).

2. Receipt by Related Party or any transferring Affiliate of cash or other (non-like-kind) property in its respective exchanges that constitutes no more than x% of the total gain realized in the exchanges and that results in recognition of gain in an equal amount will not cause § 1031(f) to make the benefits of § 1031(a) unavailable to Taxpayer in its exchange.

CAVEATS

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 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.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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.

Sincerely,

William A. Jackson
Chief, Branch 5
Office of Chief Counsel
(Income Tax & Accounting)

cc: