Internal Revenue Service
Amended 12/22/05
Number: **200540008**
Release Date: 10/7/2005
Index Number: 1001.00-00, 2501.01-00,
1015.00-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.

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Refer Reply To:
CC:ITA:B04 – PLR-161791-03

Date:
June 24, 2005

Legend:

Taxpayers =

Taxpayers' Daughter =

County =

State =

Date 1 =

Date 2 =

Date 3 =

x =

y =

z =

Dear :

This is in reply to a request for a ruling dated September 29, 2003, concerning the proper tax treatment of the taxpayers transfer of a tenancy in common interest in real property to their daughter as discussed below. [1]

FACTS

On Date 1, the taxpayers acquired a one hundred percent community property interest in real property from an inter vivos trust. The property is located in County of State, and is used as a residential rental property. The property was encumbered on Date 2 by a recourse loan that has a current balance of $x and is secured by a deed of trust. The property has a current fair market value of approximately $y and an adjusted basis as of Date 3 of $z.

Upon receipt of this ruling, the taxpayers wish to give their daughter a gift of a fifty percent undivided tenancy in common interest in the property through a grant deed. The taxpayers will retain a fifty percent undivided community ownership interest in the property, and will remain the sole obligors for the loan that encumbers the property. However, the daughter will enter into a written agreement with her parents whereby she will be responsible for repaying one half of the loan's principal balance, computed as of the time of the transfer of the interest in the property to her. Thereafter, the property will continue to be used as a residential rental property for a period of time, but will eventually become the daughter's principal residence.

The taxpayers represent that at the appropriate time, they will exercise their right under § 453(d) of the Internal Revenue Code to elect out of the installment method.

RULINGS REQUESTED

The following rulings are requested.

1. The transfer of a fifty percent undivided tenancy in common interest in the property from the taxpayers to their daughter will be treated as a sale or exchange for capital gain tax purposes under § 1001 to the extent of the amount of the consideration which the taxpayers receive from their daughter for that interest.

2. The amount of the consideration received by the taxpayers from their daughter for the fifty percent undivided tenancy in common interest in the property will equal one half of the principal balance of the loan by which the property is encumbered, determined as of the date of the transfer to their daughter.

[1] The ruling request was supplemented and amended on February 4, 2004, July 13, 2004, and March 31, 2005.

3. The taxpayers' combined basis in their fifty percent interest in the property immediately after the transfer of the property to their daughter will be one half of the property's adjusted basis immediately before such transfer.

4. The transfer of the property from the taxpayers to their daughter will not result in any income from discharge of indebtedness under § 61(a) (12) to the taxpayers.

5. The transfer described in ruling request number 1 above will be treated as a gift under § 2501 to the extent it is not treated as a sale or exchange under § 1001.

6. The daughter's basis in her fifty percent interest in the property immediately after the transfer to her will be the sum of:

(a) The greater of: i) the amount of consideration paid by the daughter for her interest in the property; or ii) one half of the taxpayers' adjusted basis in the property at the time of such transfer, and

(b) The amount of increase, if any, in basis authorized by section 1015(d) for gift tax paid.

Law and Analysis of Income Tax Issues

Section 61(a) (12) provides that gross income includes income from discharge of indebtedness.

Section 1001(a) provides that the gain from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss must be recognized, except as otherwise provided.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Section 1012 provides that the basis of property shall be its cost.

Section 1.1001-2(a)(1) of the Income Tax Regulations provides generally that the amount realized from a sale or other disposition of property includes the amount of liabilities from which the transferor is discharged as a result of the sale or disposition.

Section 1.1001-2(a) (4) (ii) provides that the sale or other disposition of property that secures a recourse liability discharges the transferor from the liability if another person agrees to pay the liability (whether or not the transferor is in fact released from liability). A disposition of property includes a gift of the property (§ 1.1001-2(a) (4) (iii)).

Although the taxpayers will remain the sole obligors for the recourse loan that encumbers the property, under the agreement their daughter will be responsible for repaying one half of the loan's principal balance, computed as of the time of the transfer of the interest in the property to her. Thus, under § 1.1001-2(a) (1) the taxpayers will be discharged from liability to that extent.

Under Crane v. Commissioner, 331 U.S. 1, 8 (l947), if a taxpayer sells property subject to a mortgage that is equal to or less than the value of the property, then the amount of the mortgage is properly included in the amount realized on the sale. However, since the property transferred to the daughter will have a fair market value in excess of the portion of the loan principal which the daughter will agree to pay, no assets offset by the obligation of the loan will be made available to taxpayers by their daughter's agreeing to repay a portion of the loan.

With respect to ruling request #1, we conclude that the transfer of a fifty percent undivided tenancy in common interest in the property from the taxpayers to their daughter will be treated as a sale or exchange for capital gain tax purposes under § 1001 to the extent of the amount of the consideration which the taxpayers receive from their daughter for that property interest.

We hold for ruling request #2, that since the taxpayers represent that they will elect out of the installment method, the amount of the consideration received by the taxpayers will equal one half of the principal balance of the loan by which the property is encumbered, determined as of the date of the transfer to their daughter.

In ruling request #3, since the taxpayers' will transfer a fifty percent undivided tenancy in common interest in the property to their daughter in consideration for her agreeing to pay one half of the principal balance of the loan by which the property is encumbered, we conclude that the taxpayers' combined basis in their fifty percent interest in the property immediately after the transfer of the property to their daughter will be one half of the property's adjusted basis immediately before such transfer.

For ruling request #4, we conclude that the transfer of the property from the taxpayers to their daughter will not result in any income from discharge of indebtedness under § 61(a) (12).

Law and Analysis of Gift Tax Issues

Section 2501 imposes a tax on the transfer of property by gift by an individual, resident or nonresident. Section 2502 provides, generally, that the tax imposed by § 2501 shall be an amount equal to the excess of --

> (1) a tentative tax on the aggregate sum of the taxable gifts for the calendar year and for each of the preceding calendar

periods, over

(2) a tentative tax on the aggregate sum of the taxable gifts for each of the preceding calendar periods.

Section 2511(a) provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-2(b) of the Gift Tax Regulations provides that as to any property of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete.

Section 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift, and shall be included in computing the amount of gifts made during the calendar year.

Section 1015(a) provides that if the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in section 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss, the basis shall be such fair market value.

Section 1.1015-4(a) of the regulations provides that, where a transfer of property is in part sale and in part a gift, the unadjusted basis of the property in the hands of the transferee is the sum of –

(1) Whichever of the following is the greater:

i) The amount of consideration paid by the transferee for the property, or

ii) The transferor's adjusted basis for the property at the time of the transfer, and

(2) The amount of increase, if any, in basis authorized by § 1015(d) for gift tax paid.

Accordingly, for ruling request #5, we conclude that the transfer by the taxpayers of a fifty percent undivided tenancy in common interest to their daughter under the circumstances described above will be treated as a gift to the extent it is not treated as a sale or exchange under § 1001.

Finally, for ruling request #6, we conclude that the daughter's basis in her fifty percent interest in the property is the greater of the amount of consideration paid by the daughter for the property, or the same as the taxpayers' (the preceding owners) adjusted basis, and the amount of increase, if any, in basis authorized by § 1015(d) for gift tax paid.

Caveats

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110.

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(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

George Wright
Assistant Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: