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Department of the Treasury
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Telephone Number:

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Date:
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TY:

Legend

Taxpayer =

Relinquished Property =
Replacement Property =
Partnership =
Date 1 =
Date 2 =
Date 3 =

Dear :

This is in response to your request for a private letter ruling dated May 14, 2007, submitted by your authorized representative. The ruling request concerns whether, for purposes of § 1031(a)(1) of the Internal Revenue Code, Taxpayer's receipt of 100 percent of the interests of the partners in a partnership that holds real property, by a disregarded entity created by Taxpayer to receive the real property, will be treated as the receipt of property that is like kind to the real property disposed of by Taxpayer under the circumstances set forth below.

FACTS

Taxpayer is a limited partnership that uses a calendar year accounting period and the accrual method of accounting. Taxpayer is in the rental real estate business and owns Relinquished Property. On Date 1, Taxpayer entered into an agreement of sale for the Relinquished Property with a third party buyer ("Buyer"), whereby Taxpayer agreed to transfer title to the Relinquished Property to Buyer for cash. On Date 2, Taxpayer entered into a deferred exchange agreement with a qualified intermediary ("QI").

Pursuant to this agreement, Taxpayer assigned its right, title and interest in the agreement of sale to the QI and notified Buyer of the assignment.

Taxpayer, QI and Buyer entered into an amended exchange agreement and assignment whereby Taxpayer and Buyer amended the agreement of sale to become an agreement of exchange pursuant to which: (1) Taxpayer agreed to transfer Relinquished Property to QI; (2) QI agreed to transfer Relinquished Property to Buyer; (3) Buyer agreed to accept Relinquished Property from QI; and (4) Buyer agreed to transfer the consideration for Relinquished Property to QI. All parties agreed that QI would instruct the settlement agent to prepare a two-party deed for Relinquished Property to be executed by Taxpayer directly to Buyer. At closing on Date 3, Taxpayer executed this deed in favor of Buyer, and QI accepted the sales proceeds from Buyer, which the QI holds in escrow for the purchase of Replacement Property.

Partnership, a limited partnership, owns Replacement Property. In order to acquire Replacement Property, Taxpayer will enter into a purchase agreement with each of the partners to acquire of 100 percent of their interests in Partnership. Taxpayer also will enter into an amended exchange agreement with QI whereby it will assign to QI all of Taxpayer's right, title and interest, as purchaser, in the purchase agreement with the partners. Taxpayer will inform the partners of this assignment. The parties thus will enter into an amended exchange agreement and assignment pursuant to which: (1) The partners agree to accept consideration for their partnership interests from the QI; (2) QI agrees to transfer such consideration to the partners; (3) The partners agree to transfer 100 percent of their interests in Partnership to QI; and (4) Taxpayer agrees to accept the Partnership interests from QI.

Taxpayer will form a wholly-owned limited liability company ("LLC") that Taxpayer represents will be considered a disregarded entity for federal tax purposes. At closing, all proceeds held by the QI will be distributed to the partners. QI will direct the partners to execute an assignment of 100 percent of their interests in Partnership to Taxpayer and LLC, who will become the new limited partner and general partner, respectively, of Partnership. Partnership will continue to operate as a state law partnership after closing.

Taxpayer represents that Relinquished Property and Replacement Property are like kind within the meaning of § 1031 and the regulations thereunder.

Taxpayer's ruling request raises two issues:

Issue 1: May Taxpayer defer gain on the sale of Relinquished Property under § 1031 if Taxpayer, through QI, acquires 100 percent of the interests of the partners in Partnership, which owns the Replacement Property.

Issue 2: May Taxpayer hold the Replacement Property in a newly-created state law partnership that is disregarded for federal income tax purposes without violating the requirement of § 1031 that the replacement property and relinquished property both must be held by the taxpayer in a trade or business or for investment.

LAW AND ANALYSIS

Section 1031 permits the deferral of gain or loss on the exchange of like-kind property. Section 1031(a)(1) provides that no gain or loss will 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(a)(2)(D) specifically excludes any exchange of "interests in a partnership" from § 1031(a)(1) deferral. Congress passed § 1031(a)(2)(D) in the Deficit Reduction Act of 1984. The accompanying legislative history indicates that Congress viewed partnership interests as similar to stocks, bonds, and other securities that historically were prohibited from § 1031 exchanges in order to prevent taxpayers from taking advantage of like-kind treatment on dispositions of certain appreciated property. Congress also wanted to eliminate the abusive practice where taxpayers exchanged their interests in burned out tax shelter partnerships for interests in other partnerships without having to realize gains. See Supplemental Report of the House Ways and Means Committee, 98th Cong., 2d Sess., H. R. Rep No. 432 (Part 2) at 1232-34 (1984).

In situation 2 of Rev. Rul. 99-6, 1999-1 C.B. 432, C and D are equal partners in CD, a limited liability company (LLC) classified as a partnership under § 301.7701-3 of the Procedure and Administration Regulations. C and D sold their entire interests in CD partnership to E, an unrelated person. After the sale, the business is continued by the LLC, which is owned solely by E. Rev. Rul. 99-6 concludes that the CD partnership terminates under § 708(b)(1)(A) when E purchased the entire interests of C and D in the CD partnership. C and D must report gain or loss, if any, resulting from the sale of their partnership interests in accordance with § 741. Although the revenue ruling characterizes C and D as having sold their partnership interests, it classifies E as having acquired all of the former CD partnership's assets. Thus, when E purchased the entire interests of C and D in CD partnership, CD partnership was deemed to have made a liquidating distribution of its assets to C and D. Immediately following this distribution, E is deemed to acquire, by purchase, all of the former CD partnership's assets.

In situation 1 of Rev. Rul. 2004-77, 2004-2 C.B. 119, X, a domestic corporation, is the sole owner of L, a domestic limited liability company (LLC). L is disregarded as an entity separate from its owner, X. L and X are the only member under local law of P, a state law limited partnership. There are no constructive or beneficial owners of P other than L and X. L and P are eligible entities that do not elect under § 301.7701-3(c) of the

Procedure and Administration Regulations to be treated as an association for federal income tax purposes. Under § 301.7701-2(c)(2) of the Procedure and Administration Regulations, L is disregarded as an entity separate from its owner, X. Because L is disregarded as an entity separate from X, X is treated as owning all of the interests in P. P is therefore a domestic entity with only one owner for federal tax purposes that has not made an election to be classified as an association taxable as a corporation. Since P has only one owner for federal tax purposes, P cannot be classified as a partnership under § 7701(a)(2). Rev. Rul. 2004-77 thus holds that if an eligible entity has two members under local law, but one member of the eligible entity is, for federal tax purposes, disregarded as an entity separate from the other member, then the eligible entity cannot be classified as a partnership and is either disregarded as an entity separate from its owner or an association taxable as a corporation.

Issue 1: Taxpayer will acquire 100 percent of the partners' interests in Partnership. Pursuant to Rev. Rul. 99-6, Partnership is considered to have terminated under § 708(b)(1)(A) and made a liquidating distribution of its real property assets to its partners, and Taxpayer is treated as having acquired such real property assets from the partners for federal tax purposes. Since Taxpayer will acquire 100 percent of the partners' interests in Partnership, Taxpayer is treated as having acquired the real property assets of Partnership rather than as having acquired partnership interests from the partners. Further, this transaction does not constitute an abuse of the type that Congress sought to remedy in the Deficit Reduction Act of 1984, which appears to be aimed at abuses by sellers of partnership interests. We view this transaction as a like-kind exchange under § 1031(a)(1), rather than as an exchange of partnership interests in violation of § 1031(a)(2)(D).

Accordingly, Taxpayer may defer the gain on the sale of Relinquished Property under § 1031 if Taxpayer, through QI, acquires 100 percent of the interests of the partners in Partnership, which owns the Replacement Property.

Issue 2: Taxpayer's formation of LLC to serve as the general partner of Partnership and the continued existence of Partnership as a state law partnership owned by LLC and Taxpayer following the closing of this transaction comply with the requirement that taxpayers hold both the relinquished property and the replacement property for productive use in a trade or business or for investment. Under § 301.7701-2(c)(2) of the Procedure and Administration Regulations, LLC would be disregarded as an entity separate from its owner, Taxpayer. Because LLC is disregarded as an entity separate from Taxpayer, Taxpayer would be treated as owning all of the interests in Partnership following the closing of this transaction. Partnership therefore would become a domestic entity with only one owner, Taxpayer, for federal tax purposes. Since Partnership will have only one owner for federal tax purposes following closing and will not make an election to be treated as an association taxable as a corporation, Partnership cannot be classified as a partnership under § 7701(a)(2) and thus would be considered disregarded as an entity separate from its owner, Taxpayer, even though it

continues as a state law limited partnership. See Rev. Rul. 2004-77. For federal tax purposes, Taxpayer would be considered the owner of the real property that constitutes Replacement Property.

Accordingly, Taxpayer may hold the Replacement Property in a newly-created state law partnership that is disregarded for federal income tax purposes without violating the requirement of § 1031 that replacement property and relinquished property both must be held by the taxpayer in a trade or business or for investment.

CONCLUSION

For purposes of § 1031(a)(1), Taxpayer's receipt of 100 percent of the interests of the partners in a partnership that holds real property, by a disregarded entity created by Taxpayer to receive the real property, will be treated as the receipt of property that is like kind to the real property disposed of by Taxpayer, provided all other requirements of § 1031 are met.

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. Specifically, we express no opinion whether the proposed transaction qualifies in all other respects for tax deferral under § 1031 beyond what is expressly stated in the above ruling.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 representative.

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 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,

Amy J. Pfalzgraf
Senior Counsel, Branch 5
Office of Chief Counsel
(Income Tax & Accounting)

cc: