Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200820017**
Release Date: 5/16/2008

Index Number: 1031.07-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B04
PLR-139907-07

Date:
February 07, 2008

TY:

Taxpayer =
RT =
LP =
State A =
State B =
Date C =
Affiliate =
Relinquished Property (RQ) =
Replacement Property 1 (RP1) =
Replacement Property 2 (RP2) =

Dear :

This responds to your request for a private letter ruling, dated September 4, 2007, as supplemented, regarding the application of § 1031(f) of the Internal Revenue Code.

FACTS:

Taxpayer is a limited liability company organized in State A that is taxed as a partnership. Through entities that are disregarded for federal income tax purposes, Taxpayer owns and operates various commercial real estate properties.

Taxpayer is also an affiliate of RT, a publicly held statutory real estate investment trust (REIT) organized in State B. RT elected to be taxed as a REIT beginning with its taxable year that ended on Date C. RT has intended to qualify as a REIT at all times since and including such year.

RT operates through an UPREIT structure. RT owns 89% of the common interest of LP, a State A limited partnership, and is its sole general partner. Various outside partners own the remaining 11% interest in LP, which in turn, owns interests in

numerous subsidiaries. RT conducts its operations and owns properties through LP and subsidiary entities.

LP owns a 99% interest in Taxpayer and is its managing member. The remaining 1% interest in Taxpayer is held by Affiliate. LP owns 99.9% of Affiliate and the remaining 0.1% is owned by various individuals and an entity.

Taxpayer is the lessee of an office building (RQ) under a 99-year lease with more than 75 years remaining, which Taxpayer intends to exchange for like-kind property. Taxpayer has identified two properties (RP1 and RP2 respectively), as its replacement property. Taxpayer will acquire these properties from LP through a qualified intermediary (QI) in a deferred like-kind exchange.

LP also intends to engage in its own deferred like-kind exchange in connection with its transfer of RP1 and RP2 as its relinquished property and will timely acquire replacement property from an unrelated third party through a QI. LP expects that the value of LP's replacement property may be somewhat less than the aggregate value of RP1 and RP2, or that there may be a somewhat higher mortgage on LP's replacement property than the existing mortgages on RP1 and RP2. As a result, some cash will be paid or treated as paid to LP on or after the earlier of the 181st day from the transfer of RP1 and RP2 or the receipt of all property which LP is entitled to receive under its exchange agreement. This will constitute taxable boot to LP. However, under no circumstances will the amount of boot to be received exceed % of the gain realized.

Neither Taxpayer nor LP will dispose of its respective replacement properties before two years from the later acquisition of the respective replacement properties.

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. Under § 1.1031(a)-1(c) of the Income Tax Regulations, a lessee that exchanges a leasehold interest in real property of 30 years or more for a fee interest in real property is considered to have exchanged like-kind property for purposes of § 1031.

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 RQ for RP1 and RP2 because Taxpayer is exchanging property with a QI, who is not a related person. 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 Ways and Means Committee Report and the 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 QI 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]

In the present case, the only transaction planned by the parties after Taxpayer receives RP1 and RP2 as its replacement property is the acquisition by LP of LP's replacement property in another exchange under § 1031, a nonrecognition transaction. Because LP is also structuring its disposition of RP1 and RP2 as an exchange for like-kind replacement property, neither § 1031(f)(4) nor Rev. Rul. 2002-83 applies. Taxpayer's exchange and LP's exchange are structured as like-kind exchanges qualifying under § 1031. There is no "cashing out" of either party's investment in real estate. Upon completion of the series of transactions, both related parties will own property that is like-kind to the properties they exchanged. Moreover, neither party will have ever been in receipt of cash or other nonlike-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 nonlike-kind property by LP from its QI, in an amount not greater than % of LP's realized gain, will not result in gain recognition by Taxpayer.

RULING:

1. Section 1031(f) will not apply to require Taxpayer to recognize the gain realized in Taxpayer's exchange of RQ for RP1 and RP2 or LP's exchange of RP1 and RP2 for LP's replacement property, provided that neither Taxpayer nor LP disposes of their respective replacement properties within two years of the later of Taxpayer's receipt of RP1 and RP2 or LP's receipt of LP's replacement property.

2. LP's receipt of cash or other (nonlike-kind) property, in addition to LP's replacement property, from its QI, will not cause Taxpayer to recognize gain under §1031(f).

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.

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.

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

[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 p. 152.

attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Michael J. Montemurro
Chief, Branch 4
(Income Tax & Accounting)