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May 22, 2018

LEGEND

Taxpayer =

LLC1 =
LLC2 =
LLC3 =

LLC4 =

Affiliate
=
X =
Y =
Date 1 =
$ a =
$ b =
$ c =
$ d =
$ e =
$ f =

Dear :

This is in response to a request for a private letter ruling submitted on your behalf by your authorized representative. Specifically, you request a ruling that certain dispositions of real property acquired from a related party in a previous like-kind exchange satisfy the requirements of §1031(f)(2)(C) of the Internal Revenue Code.

FACTS

Taxpayer is a multi-member limited liability company that is treated as a partnership for federal income tax purposes. Taxpayer uses the calendar taxable year and the accrual method of accounting for federal income tax purposes. LLC1 and LLC2 are each a single-member limited liability company, wholly owned by Taxpayer, that is disregarded for federal income tax purposes. LLC3 is a partnership for federal income tax purposes, with Taxpayer and others as partners, each holding a capital interest in LLC3.

LLC4 is a single-member limited liability company, wholly owned by LLC3 through five tiers of other wholly-owned single-member limited liability companies, each of which is disregarded for federal income tax purposes. Taxpayer will continue to own indirectly more than X percent of the interests in LLC4 through LLC3.

Affiliate is treated as a corporation for federal income tax purposes, and uses the calendar year and the accrual method of accounting for federal income tax purposes. On Date 1, Affiliate was a "related person" to Taxpayer as that term is defined under § 1031(f)(3) of the Code.

On Date 1, Taxpayer, through disregarded entities, acquired (i) two parcels of land (collectively, Property 1) and (ii) one parcel of land (Property 2), as replacement property in a direct like-kind exchange between Taxpayer and Affiliate, treating the transaction as an exchange under § 1031 (Initial Exchange). In the exchange, LLC1 acquired Property 1 with an aggregate estimated market value of $ a and an aggregate estimated tax basis of $ b, and LLC2 acquired Property 2 with a fair market value of $ c and an estimated tax basis of $ d, in exchange for relinquishing several properties, with an aggregate estimated market value of $ e and an aggregate estimated tax basis of $ f, to Affiliate. All relinquished and replacement properties transferred as part of the Initial Exchange were free and clear of any debt.

Taxpayer, through LLC1, will dispose of Property 1 as part of a second like-kind exchange under § 1031 of the Code (Second Exchange). The purpose of this transaction is to acquire further property as replacement property to be utilized as Taxpayer continues its trade or business. Taxpayer will not receive any cash or other non-like kind property in the Second Exchange.

In addition, Taxpayer, through LLC2, will dispose of Property 2 to LLC4 (by merger, which will be accounted for as a contribution of Y percent of Taxpayer's interest in LLC2) through LLC3 (Contribution). The Contribution will be solely in exchange for an additional interest in LLC3, the value of which will equal the value of the property contributed, with no cash or other consideration received by Taxpayer. The Contribution will be treated as a contribution to a partnership under § 721 of the Code.

Affiliate still owns all the property it acquired from Taxpayer in the Initial Exchange and, to Taxpayer's knowledge, Affiliate has no intent to dispose of the property. Furthermore, at the time of the Initial Exchange, Taxpayer did not intend, nor had a prearranged plan, to enter into the subsequent transactions discussed in this ruling.

REQUESTED RULINGS

1. Whether the disposition of Property 1 as part of the Second Exchange will qualify for the non-tax avoidance exception under § 1031(f)(2)(C).

2. Whether the disposition of Property 2 to LLC4 through LLC3 as part of the Contribution will qualify for the non-tax avoidance exception under § 1031(f)(2)(C).

APPLICABLE LAW & ANALYSIS

Section 1031(a)(1) of the Code provides that no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment if the property is exchanged solely for real property of like kind to be held either for productive use in a trade or business or for investment.

Section 1031(f)(1) provides that if—(A) a taxpayer exchanges property with a related person (the first disposition), (B) there is nonrecognition of gain or loss to the taxpayer under § 1031 on the first disposition (determined without regard to § 1031(f)), and (C) before the date 2 years after the date of the last transfer that was part of the first disposition—

(i) the related person disposes of the property, or
(ii) the taxpayer disposes of the property received in the exchange from the related person that was of like kind to the property transferred by the taxpayer (both (i) and (ii) referred to as the second disposition),

there is no nonrecognition of gain or loss under § 1031 to the taxpayer on the first disposition. Any gain or loss recognized by the taxpayer by reason of § 1031(f) must be taken into account as of the date on which the second disposition occurs.

Section 1031(f)(2)(C) provides that, for purposes of the application of § 1031(f)(1)(C), a second disposition is not taken into account if it is established to the satisfaction of the Secretary that neither the first disposition nor the second disposition had as one of its principal purposes the avoidance of federal income tax.

Section 1031(f)(4) provides that § 1031 does not apply to any exchange that is part of a transaction (or series of transactions) structured to avoid the purposes of § 1031(f). Thus, if a transaction with a related party is set up with tax avoidance as one of its principal purposes, § 1031 will not apply to this series of transactions.

Both the Ways and Means Committee Report and the Senate Finance Committee Print, describe the policy concern that led to enactment of § 1031(f):

> 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 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 (1989).

The Senate Finance Committee Print, however, also gives three examples of situations for which it is deemed established for purposes of § 1031(f)(2(C) that neither the exchange nor the subsequent disposition has as one of its principal purposes the avoidance of federal income tax. One of the three involves "... dispositions of property in nonrecognition transactions." S. Print. No. 56, 152.

In the present case, the acquisitions of replacement property by Taxpayer through LLC1 and LLC2 from Affiliate, a related party to Taxpayer, in the Initial Exchange will be followed by dispositions, within 2 years of the Initial Exchange, of the property in nonrecognition transactions. LLC1 will dispose of Property 1 as part of a like-kind exchange under § 1031 in the Second Exchange and Taxpayer has represented that it will not receive any cash or other non-like kind property in the Second Exchange. In addition, LLC2 will dispose of Property 2 in a nonrecognition transaction under § 721, with no cash or other consideration received by Taxpayer. LLC1 and LLC2 are disregarded entities so the dispositions of both Property 1 and Property 2 are considered to have been made by Taxpayer. Since both dispositions are in nonrecognition transactions and Taxpayer receives neither cash nor other consideration that would trigger gain in the dispositions, the dispositions are, under § 1031(f)(2)(C), ignored in determining whether § 1031(f) applies to require gain recognition in the Initial Exchange.

RULINGS

1. The disposition of Property 1 as part of the Second Exchange will qualify under § 1031(f)(2)(C). Thus, the disposition of Property 1 as part of the Second Exchange will, under § 1031(f)(2)(C), not be taken into account in determining whether Taxpayer disposed of Property 1 within 2 years of the Initial Exchange.

2. The disposition of Property 2 to LLC4 through LLC3 will qualify under § 1031(f)(2)(C). Thus, the disposition of Property 2 as part of the Contribution will, under § 1031(f)(2)(C), not be taken into account in determining whether Taxpayer disposed of Property 2 within 2 years of the Initial 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. In particular, we express no opinion concerning whether the disposition of Property 1 is in a transaction to which § 1031 applies, or whether the disposition of Property 2 is in a transaction to which § 721 applies.

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.

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,

Stephen J. Toomey
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)