Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:ITA:B04
PLR-110023-20

Date:
October 06, 2020

Taxpayer 1	=
EIN	=
State 1	=
Company 1	=
EIN	
Company 2	=
EIN	
State 2	=
Company 3	=
EIN	
Company 4	=
EIN	=
Property 1	=
Property 2	=
Property 3	=

Property 4 =

Property 5 =

Date 1 =

Qualified Intermediary =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear :

This letter responds to your private letter ruling request, dated April 13, 2020, regarding whether, under § 1031(f) of the Internal Revenue Code, Taxpayer is disqualified from deferring gain on a like-kind exchange because Taxpayer acquired replacement property from a related person.

Facts

Taxpayer is a corporation organized in State 1. Company 1 is an S corporation and Company 4 is a limited liability company that is classified as a partnership and both are organized in State 1. Company 2 and Company 3 are limited liability companies that elected to be classified as a corporation and partnership, respectively, and are both located in State 2.

Taxpayer is a related person as defined in § 1031(f)(3) ("related person") to both Company 1 and Company 2. Additionally, Company 2 and Company 3 are related persons, and Company 3 and Company 4 are related persons.

On Date 1, Taxpayer entered into a deferred exchange agreement with Qualified Intermediary to engage in a § 1031 like-kind exchange. On Date 2, a disregarded entity of Taxpayer conveyed Property 1 as relinquished property in its exchange to an unrelated person. As its replacement property, Taxpayer, on Date 3, acquired Property

2, which was owned by Company 1 prior to the acquisition, and Property 3, which was owned by Company 2 prior to the acquisition. Company 1 and Company 2 are related persons to Taxpayer. Taxpayer's replacement property also included property acquired from unrelated persons. Taxpayer did not receive any cash or non-like kind property (boot) in the exchange.

On Date 3, Company 1 entered into a deferred exchange agreement with Qualified Intermediary to engage in a § 1031 like-kind exchange. Company 1 conveyed Property 2 as relinquished property in its exchange to Taxpayer and acquired replacement properties, all of which were owned by unrelated persons prior to Company 1's acquisition. Company 1 did not receive any boot in the exchange.

On Date 3, Company 2 entered into a deferred exchange agreement with Qualified Intermediary to engage in a § 1031 like-kind exchange. Company 2 conveyed Property 3 as relinquished property in its exchange to Taxpayer and acquired Property 4, which was owned by Company 3, a related person, prior to Company 2's acquisition. Company 2 did not receive any boot in the exchange.

On Date 4, Company 3 entered into a deferred exchange agreement with Qualified Intermediary to engage in a § 1031 like-kind exchange. Company 3 conveyed Property 4 as relinquished property in its exchange to Company 2 and, on Date 5, acquired an interest in Property 5, which was owned by Company 4, a related person, prior to Company 3's acquisition. Company 3 did not receive any boot in the exchange.

On Date 5, Company 4 entered into a deferred exchange agreement with Qualified Intermediary to engage in a § 1031 like-kind exchange with respect to Company 4's relinquished property, Property 5. Company 4 will acquire replacement property owned by persons unrelated to Taxpayer, Company 1, Company 2, Company 3, and Company 4. Company 4 will receive no boot in its exchange.

Applicable Law

Section 1031(a)(1) 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 such real property is exchanged solely for real property of a like kind that is to be held either for productive use in a trade or business or for investment.

Section 1031(f)(1) provides that if a taxpayer exchanges property with a related person, the taxpayer is precluded from the nonrecognition of gain or loss under § 1031 on the exchange of such property if, before the date 2 years after the date of the last transfer that was part of the exchange[1], the related person disposes of the property, or 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 (referred to as "the

[1] See § 1031(f)(2) for certain dispositions that are not taken into account under § 1031(f)(1).

subsequent disposition by the related person or the taxpayer"). 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 subsequent disposition by the related person or the taxpayer occurs.

Section 1031(f)(2)(C) provides that a subsequent disposition by the taxpayer or a related person is not taken into account if it is established to the satisfaction of the Secretary that neither the taxpayer's exchange nor the subsequent disposition by the related person or the taxpayer had as one of its principal purposes the avoidance of federal income tax.

Under § 1031(f)(4), § 1031 does not apply to an 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 § 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 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. *See* H.R. Rep. No. 247, 101st Cong. 1st Sess. 1340 (1989); S. Print. No. 56, at 151.

The committee reports also contain the following example of when § 1031(f)(4) applies:

> If a taxpayer, pursuant to a pre-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. *See* 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 in § 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. *See* S. Print. No. 56, at 152.

In Rev. Rul. 2002-83, 2002-2 C.B. 927, a taxpayer transferred low-basis property to an unrelated buyer through a qualified intermediary (QI) and acquired high-basis replacement property from a related person, through the QI, with the proceeds of the sale of the relinquished property. The taxpayer and the related person structured the transaction to cash out of their investment in the low-basis relinquished property without recognizing gain. The related person had $0 of realized gain on its sale of the high-basis replacement property and the taxpayer used § 1031 to defer the realized gain on the disposition of the low-basis 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 an unrelated person, such as a QI, is used to effectuate a like-kind exchange between related parties of high-basis property for low basis property in anticipation of the sale of the low-basis property. In these situations, had the taxpayer engaged in a direct exchange with the related person, without the use of an unrelated person such as QI, followed by an immediate sale by the related person of the property formerly owned by the taxpayer, § 1031(f)(1) would apply and gain recognition would be triggered in the year of the subsequent disposition by the related person. The Service concluded that the transaction described in the revenue ruling was structured to avoid the purposes of § 1031(f) and, therefore, the taxpayer must recognize the gain realized on its transfer of the relinquished property.

Analysis

In the present case, Taxpayer exchanged Property 1 for Property 2 and Property 3, both of which were owned by a related person, using Qualified Intermediary to facilitate the exchange. Consequently, § 1031(f)(1) does not apply because Qualified Intermediary is not a related person to the Taxpayer. However, under § 1031(f)(4), § 1031 does not apply to Taxpayer's exchange if the exchange is part of a transaction (or series of transactions) structured to avoid the purposes of § 1031(f).

Here, Taxpayer contends that § 1031(f)(2)(C) applies. Company 1 and Company 2, the related persons that owned Property 2 and Property 3, respectively, prior to Taxpayer's acquisition of those properties, transferred the properties as part of their own like-kind exchanges that Taxpayer represents were nonrecognition transactions in which no boot was received by Company 1 or Company 2. Company 1 transferred as relinquished property Property 2 to Taxpayer as part of a like-kind exchange in which all Company 1's replacement property was formerly owned by an unrelated person. Company 2 transferred as relinquished property Property 3 to Taxpayer as part of a like-kind exchange in which some of Company 2's replacement property was formerly owned by Company 3, a related person to Company 2, and some was formerly owned by an unrelated person. Likewise, Company 3 transferred as relinquished property Property 4 to Company 2 as part of its own like-kind exchange in which all of Company 3's replacement property was owned by Company 4, a related person to Company 3. Finally, Taxpayer also represents that Company 4's transfer of property to Company 3 will be part of its own like-kind exchange in which all of its replacement property will be acquired from unrelated persons. Taxpayer represents that all of the entities will continue to own the property received in its exchanges for at least two years after the date of the last transfer in the series.

Taxpayer asserts that there is no cashing out by Taxpayer or any of the related persons. That is because Taxpayer, Company 1, Company 2, Company 3, and Company 4 did not or will not receive cash or any non-like-kind property in the exchanges, and upon completion of the series of transactions, all related persons will own property that is of like kind to the property the respective entity transferred in its exchange.

Based on the facts and representations submitted by the Taxpayer, we rule as follows:

> Section 1031(f)(1) does not apply to Taxpayer's exchange of Property 1 for Property 2 and Property 3, and the other transactions described in this ruling are not, as described in section 1031(f)(4), part of a transaction (or series of transactions) structured to avoid § 1031(f) from applying to Taxpayer's exchange of Property 1 for Property 2 and Property 3. Consequently, the transactions described in this ruling involving Company 1, Company 2, Company 3, and Company 4 do not disqualify Taxpayer from deferring gain under § 1031 for Taxpayer's exchange of Property 1 for Property 2 and Property 3.

Pursuant to section 7.06 of Rev. Proc. 2020-1, 2020-1 I.R.B. 1, Taxpayer must attach a copy of this letter ruling to any Federal income tax return to which it is relevant. If Taxpayer files its returns electronically, it may satisfy this requirement by attaching a statement to the return that provides the date and control number of this letter ruling.

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.

The ruling contained in this letter is based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. However, this office has not verified any of the material submitted in support of the request for this ruling, and therefore it is subject to verification on examination.

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.

Pursuant to the provisions of a power of attorney currently on file, we are sending a copy of this letter ruling to Taxpayers' authorized representatives,
and .

If you have any questions concerning this matter, please contact at .

Sincerely,

SJT

Stephen J. Toomey
Senior Counsel
(Income Tax & Accounting)

cc: