Internal Revenue Service

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TY:

LEGEND:

Taxpayer =
RQ =
RP#1 =
RP#1 LLC =
RP#2 =
RP#2 LLC =
LLC#3 =
Parent =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
$x =
$y =
$z =
1st TierSub-LLC =
2nd TierSub-LLC =
Operating Partnership =

Dear

This responds to your request for a private letter ruling, dated July 11, 2011, regarding the application of § 1031(a) of the Internal Revenue Code to your proposed transaction. The question you raise is whether § 1031(f) affects the applicability of § 1031(a) in the case of a series of transactions between related parties if each transaction in the series otherwise qualifies as a like-kind exchange under § 1031(a), and none of the related

parties receive more than a minimal amount of non-like-kind property in their transactions.

FACTS:

Taxpayer is a corporation that elected to be taxed as a real estate investment trust (REIT) beginning prior to the year of the transactions at issue. Taxpayer uses an annual accounting period ending December 31 and the overall accrual method of accounting for maintaining its books and records and filing its federal income tax returns. Through entities disregarded for federal income tax purposes, Taxpayer owned and operated a commercial real estate project, as more fully described below.

1. Taxpayer's Organizational Structure.

Taxpayer is an affiliate of Parent, which is also a REIT. Parent owns 92 percent of Operating Partnership (OP) and is its sole general partner. Parent conducts its operations and owns various properties through OP and subsidiary entities. OP owns 100 percent of the membership interest in LLC#3, which is disregarded for federal income tax purposes. LLC#3 owns 99.9 percent of the stock of Taxpayer (and 125 unrelated persons own the remaining .01 percent of Taxpayer's stock). OP's subsidiaries also include RP#2 LLC, an entity disregarded for federal income tax purposes.

Taxpayer owns 100 percent of the membership interest in 1st TierSub-LLC (1st Tier) and 1st Tier owns 100 percent of the membership interest of 2nd TierSub-LLC (2nd Tier). 2nd Tier held fee title to improved real property, which is Taxpayer's relinquished property (RQ). Both 1st Tier and 2nd Tier are disregarded for federal income tax purposes, making Taxpayer the owner of RQ for federal income tax purposes. Through these disregarded entities, Taxpayer held RQ for productive use in its trade or business or for investment prior to its disposition.

2. The Exchange Transactions.

A. Taxpayer's Exchange

Taxpayer engaged in both a parking arrangement, and a deferred exchange involving an exchange accommodation titleholder (EAT), a qualified intermediary (QI) and a qualified trust (QT).[1] On Date 1, Taxpayer and QI entered into a qualified exchange

[1] Taxpayer describes specific steps in these combined transactions, including Taxpayer entering into exchange agreements, qualified trust agreements, assignments, notices of assignments, etc. Taxpayer represents that all requirements for deferral in these transactions under the safe harbor rules of § 1.1031(k)-1 of the Income Tax Regulations and the relevant revenue procedures were followed or will be followed by Taxpayer and related parties involved in the series of exchanges described in this letter.

accommodation arrangement (QEAA) as permitted under Rev. Proc. 2000-37, 2000-2 C.B. 308. Pursuant to this QEAA, also on Date 1, Taxpayer and QI caused EAT to acquire 100 percent of the membership interest of RP #1 LLC (the fee title holder of RP #1 and an entity disregarded for federal income tax purposes) from an unrelated seller.

Taxpayer timely identified RQ as relinquished property in connection with the QEAA for RP#1. On Date 2, through QI, Taxpayer conveyed RQ to an unrelated buyer by direct deed for $x. On Date 3, QI tendered $y to EAT and EAT conveyed RP#1 to Taxpayer. Following Taxpayer's acquisition of RP#1, QI retained $z of the funds from the sale of RQ.

On Date 4, which was within 45 days of the sale of RQ, Taxpayer identified RP#2 as additional replacement property in its exchange of RQ. No other potential replacement properties were identified. RP#2 was owned by RP#2 LLC, a wholly-owed disregarded subsidiary of OP (a related party to Taxpayer). On Date 5 (within 180 days of the disposition of RQ), Taxpayer completed its exchange through QI by acquiring 100 percent of the membership interest in RP#2 LLC, which holds RP#2, for an amount exceeding $z.

B. OP's Exchange

On Date 5, OP entered into a deferred exchange agreement with a QI to engage in its own like-kind exchange that fully complies with § 1031 and the regulations thereunder. Taxpayer's RP#2 also constitutes OP's relinquished property (OPRQ). OP made timely identification of three potential replacement properties, including properties held by unrelated third parties and by entities related to OP (Affiliates). OP intends to acquire replacement properties for an amount equal to the sale price of OPRQ less transaction costs. However, if OP acquires replacement property having a value less than 100 percent of the value of the OPRQ, OP will receive non-like-kind replacement property to the extent of the difference and recognize the gain arising from the exchange in the full amount of such difference. The amount of non-like-kind property that OP will receive in its § 1031 exchange will not exceed 5 percent of the gain realized by OP on its transfer of the OPRQ. OP will timely acquire some or all of the identified replacement property, which may include property currently held by Affiliates. Replacement may occur either by direct transfer to OP by deed or by transfer of 100 percent of the membership interests in the limited liability company holding title.

C. Affiliate Exchanges

To the extent any OP replacement property is owned by an Affiliate prior to transfer of such property to OP, the Affiliate will enter into a deferred exchange agreement with a QI providing for the Affiliate's exchange of those OP replacement properties that it

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Since these steps are not directly relevant to the rulings sought by Taxpayer, this letter will not describe all these steps with the same amount of detail given in Taxpayer's ruling application.

transfers to OP (Affiliate RQ). Each deferred exchange agreement entered into by an Affiliate will comply with § 1031 and the regulations thereunder.

Before the expiration of the statutory identification period, the transferring Affiliate will identify potential replacement property in accordance § 1031 and the applicable regulations. All potential Affiliate replacement property will be owned by third parties unrelated to Taxpayer, OP or the transferring Affiliate. Each transferring Affiliate will acquire ownership of some or all of the potential Affiliate replacement property within the statutory replacement period.

To fully defer gain realized on the transfer of the Affiliate RQ, QI must use all of the proceeds from the Affiliate RQ to acquire like-kind replacement property. In the event that any Affiliate acquires replacement property through QI having a value less than 100 percent of the applicable Affiliate RQ, Affiliate will receive non-like-kind property to the extent of the difference and recognize gain arising from the exchange in the amount of such difference. However, the amount of non-like-kind replacement property acquired by an Affiliate (and thus the amount of gain recognized) will not exceed 5 percent of the gain realized by the Affiliate on its transfer of the Affiliate RQ.

Taxpayer represents that Taxpayer, OP and Affiliates will hold their replacement properties for at least two years after the date of the last transfer of property in the series of exchanges described in this letter.

APPLICABLE LAW & ANALYSIS:

Section 1031(a)(1) of the Code provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for 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, (B) there is nonrecognition of gain or loss to the taxpayer under § 1031 on the exchange of such property (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 exchange—

(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,

there is no nonrecognition of gain or loss under § 1031 to the taxpayer on the exchange. 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 disposition referred to in (C) occurs.

Section 1031(f)(2)(C) provides that, for purposes of the application of § 1031(f)(1)(C), a disposition is not taken into account if it is established to the satisfaction of the Secretary that neither the exchange nor the 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).

Section 1031(f)(1) is not applicable to Taxpayer's exchange of RQ for RP#1 because RP#1 was acquired by EAT from an unrelated party in a manner that, as represented, is consistent with the provisions of Rev. Proc. 2000-37, 2000-1 C.B 308. Further, § 1031(f)(1) is not applicable to Taxpayer's exchange of RQ for RP#2 because Taxpayer is exchanging property with QI, who is not a related person to Taxpayer. However, under § 1031(f)(4), if Taxpayer is using QI or EAT to structure its transactions with tax avoidance as one of its principle purposes, § 1031 will not apply to this series of transactions. *See, e.g., Teruya Brothers Ltd. v. Commissioner,* 580 F.3d 1038 (9th Cir. 2009); *Ocmulgee Fields v. Commissioner,* 613 F.3d1360 (11th Cir. 2010); and Rev. Rul. 2002-83, 2002-2 C.B. 927.

Both the House Ways and Means Committee and the Senate Finance Committee disclosed the policy concern that led to the 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.

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 only acquisitions of replacement property from related parties will be as part of subsequent like-kind exchanges by the related parties, which will substantially constitute nonrecognition transactions. OP will be relinquishing property to

Taxpayer as part of its own like-kind exchange with one or more related parties (Affiliates), and the Affiliates will relinquish property to OP as part of their separate like-kind exchanges for replacement property from one or more unrelated parties. Since both OP and any transferring Affiliate will also structure its disposition of property as an exchange for like-kind replacement property, neither § 1031(f)(1) nor (f)(4) apply to trigger gain recognition in Taxpayer's exchanges or to disqualify the application of § 1031 to this series of exchanges. Furthermore, there is no material cashing out by any of the related parties within 2 years of the last transfer in the series of transactions because neither Taxpayer, OP nor an Affiliate will receive non-like-kind replacement property greater than 5 percent of the gain realized on its disposition of relinquished property. Upon completion of the series of transactions, all related parties will own property that is of like kind to the properties exchanged for at least two years after the date of the last transfer in the series.

RULING:

1. Section 1031(f)(1) and (f)(4) do not apply to disqualify Taxpayer from the benefits of § 1031(a) in its exchange with related parties provided that (A) each related party transferring replacement property into the series of exchanges also engages in its own like-kind exchange, and (B) Taxpayer and the related parties hold their replacement properties for at least two years after the date of the last transfer of property in the series of exchanges described in this letter.

2. Receipt by OP or any transferring Affiliate of non-like-kind property equal to no more than 5 percent of the gain realized by OP or the Affiliate in its exchange will not result in the application of § 1031(f) to Taxpayer in its 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. 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 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. 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,

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

cc: