

**IRS RULING:
EXCHANGING WITH RELATED PARTIES
LTR 200810016**

Following the holding of earlier rulings on the same topic, this ruling holds that the taxpayer may acquire replacement property from a related party if the related party is also doing an exchange into a replacement property.

The taxpayer intends to sell the relinquished property to an unrelated party and acquire the replacement property from a related party. The related party then intends to use the exchange proceeds to acquire a replacement property in the related party's exchange. Both the taxpayer and related party will engage QIs to complete their exchanges and both will hold their replacement properties for two years following the receipt of the later of the replacement properties (other than a disposition under §1031(f)(2)). The ruling first finds that §1031(f)(1) is not applicable because the taxpayer is exchanging with an unrelated QI. Referencing Congressional policy statements and commentary regarding § 1031(f)(2)(C), it then finds that § 1031(f)(4) does not apply either. Section 1031(f)(4) provides that an exchange is taxable if it is part of a transaction, or series of transactions, structured to avoid the purposes of § 1031(f). In this case, there will be no "cashing out" of either party's investment in real estate. Upon completion of the series of transactions, both parties will own property that is of like kind to the property they exchange.

LETTER 200810016:

Dec. 6, 2007

Index Number: 1031.05-00, 1031.06-00

Release Date: 3/7/2008

Dear * * *:

This responds to your request for a private letter ruling, dated November 1, 2007. Specifically, you have requested a ruling that § 1031(f) of the Internal Revenue Code will not require the recognition of gain by related parties engaging in exchanges of like-kind property.

FACTS

AB LLC and CD LLC are both classified as partnerships for federal income tax purposes and are related persons within the meaning of § 1031(f)(3). AB LLC owns Blackacre and CD LLC owns Greenacre. AB LLC has agreed to transfer Blackacre to an unrelated buyer (Buyer). AB LLC intends to sell Blackacre as part of a deferred like-kind exchange for replacement property in a transaction intended to qualify for nonrecognition treatment under § 1031. AB LLC intends to identify Greenacre as one of the potential replacement properties in its exchange. CD LLC also intends to dispose of Greenacre and use the proceeds from the disposition to acquire like-kind property (CD LLC's replacement property) in a transaction intended to qualify for nonrecognition treatment under § 1031.

To facilitate their exchanges, AB LLC and CD LLC will enter into exchange agreements with a qualified intermediary ("QI") in accordance with § 1.1031(k)-1(g)(4) of the Income Tax Regulations. Pursuant to AB LLC's exchange agreement, QI will be treated as the seller of Blackacre to Buyer. Moreover, QI will be treated as acquiring Greenacre from CD LLC and transferring it to AB LLC in exchange for Blackacre. Similarly, in accordance with to CD LLC's exchange agreement, QI will be treated as acquiring CD LLC's

replacement property to replace Greenacre and transferring it to CD LLC in exchange for Greenacre. CD LLC's replacement property will be acquired through QI from a seller that is not related to either AB LLC or CD LLC within the meaning of § 1031(f)(3).

Once all of the transactions are completed, assuming AB LLC acquires Greenacre as replacement property in its exchange, Buyer will own Blackacre, AB LLC will own Greenacre, and CD LLC will own CD LLC's replacement property. If AB LLC acquires Greenacre as replacement property in AB LLC's exchange, AB LLC will not dispose of Greenacre, and CD LLC will not dispose of CD LLC's replacement property, within two years of AB LLC's receipt of Greenacre or CD LLC's receipt of CD LLC's replacement property (whichever is later) other than a disposition described in § 1031(f)(2).

LAW & ANALYSIS

Section 1031(a)(1) generally 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.

Section 1031(f) establishes special rules for exchanges between related persons. 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 in accordance with § 1031 with respect to the exchange; and (C) within 2 years of the date of the last transfer that was part of the exchange either the taxpayer or the related person disposes of the property received in the exchange, then there is no nonrecognition of gain or loss in the exchange. In other words, the gain or loss that was deferred under § 1031 must be recognized. Any gain or loss the taxpayer is required to recognize by reason of § 1031(f)(1) is taken into account as of the date of the disposition of the replacement property (the second disposition).

Section 1031(f)(2) provides that certain dispositions will not be taken into account for purposes of § 1031(f)(1)(C). These include any disposition (A) after the earlier of the death of the taxpayer or the death of the related person, (B) in a compulsory or involuntary conversion (within the meaning of § 1033) if the exchange occurred before the threat or imminence of such conversion or (C) with respect to which it is established to the satisfaction of the Secretary that neither the exchange nor the second 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). Thus, if a transaction is set up to avoid the restrictions on exchanges between related persons, § 1031(f)(4) operates to prevent nonrecognition of the gain or loss on the exchange.

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.

Further, in its explanation of § 1031(f)(2)(C), the Conference Committee Report states that "the non-tax avoidance exception generally will apply to . . . dispositions in nonrecognition transactions. . . ." H.R. Rep. No. 386, 101st Cong., 1st Sess. 614 (1989).

Section 1031(f)(1) is not applicable to currently tax AB LLC's disposition of Blackacre in the present case because AB LLC is exchanging property with a qualified intermediary, who is not a related party. 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). Thus, § 1031 will not apply if AB LLC's

exchange with QI is structured to avoid the purposes of § 1031(f). See Rev. Rul 2002-83, 2002-2 C.B. 927.

In the present case, the only subsequent disposition of replacement property contemplated by the parties is the use of the proceeds from the disposition of Greenacre by CD LLC to acquire CD LLC's replacement property in another exchange under § 1031, a nonrecognition transaction. Therefore, § 1031(f)(4) will not apply to require recognition of gain or loss in the exchanges of either related party. Both AB LLC's exchange and CD LLC'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 of like kind to the property they exchange. Neither exchanger will receive cash or other unlike-kind property (other than some possible boot) in return for the relinquished property.

RULING

Assuming AB LLC acquires Greenacre as replacement property in its exchange for Blackacre, CD LLC transfers Greenacre as part of its own exchange for CD LLC's replacement property, and both AB LLC and CD LLC retain their replacement properties for two years after the receipt of Greenacre by AB LLC or CD LLC's replacement property by CD LLC, whichever occurs later, then § 1031(f) will not apply to require gain recognition by either AB LLC or CD LLC.

CAVEATS

These rulings relate only to the application of § 1031(f) to the exchanges described. No opinion is expressed regarding whether the other requirements of § 1031 are met. Nonrecognition treatment does not apply to the extent of any boot in the form of cash or other unlike-kind real, personal or intangible property received by AB LLC or CD LLC in the exchanges at issue. See § 1031(b); and Rev. Rul. 67-255, 1967-2 C.B. 270.

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 rulings contained in this letter are based upon information and representations submitted by the applicant taxpayer and accompanied by penalty of perjury statements 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.

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. We enclose a copy of the letter for this purpose. 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. Also enclosed is a copy of the letter showing the deletions proposed to be made when it is disclosed under § 6110.

Sincerely,

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