Internal Revenue Service

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**Department of the Treasury**

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**Person to Contact:**

**Telephone Number:**

**Refer Reply To:**
CC:IT&A:4 -- PLR-159942-02
**Date:**
April 7, 2003

Taxpayer =
Parent =
Company =
LLC =

C Facility =
sub-facility =
State A =
State B =
State C =
Town X =
Date X =
Landlord =
Bank A =
$X =
$Z =
x =
Site Y =

Relinquished Property (RQ) =

Replacement Property (RP) =

Dear :

This responds to your letter, dated October 29, 2002, requesting a private letter ruling under §1031 of the Internal Revenue Code that no gain or loss will be recognized upon the conveyance of RQ and the receipt of RP.

APPLICABLE FACTS:

Parent is a publicly-traded State A corporation that is engaged in the business of owning and operating C Facilities. Parent is the sole shareholder of several subsidiaries, including Taxpayer. Taxpayer holds title to approximately 100 fee-owned properties improved with C Facilities. These C Facilities are operated by Parent, which compensates Taxpayer for the use of the facilities. Parent files a consolidated federal tax return that includes Taxpayer, as well as its other wholly-owned subsidiaries.

The only other party involved in the proposed exchange (besides an unidentified, unrelated party who will be the eventual transferee of RQ) is Company. Company will serve as both a qualified intermediary (QI) and an exchange accommodation titleholder (EAT) in the proposed transaction. Company also includes a special purpose limited liability company (LLC) that will be organized under the laws of State C. LLC will be wholly owned by Company, will be formed immediately prior to Company's acquisition of RP in its capacity as EAT and will be a disregarded entity.

Taxpayer proposes to exchange RQ for RP in a transaction intended to qualify for deferral under §1031. RQ is currently used in Taxpayer's business. Taxpayer intends to acquire RP for use in its business. The business purpose of the proposed transaction is to dispose of an existing sub-facility and acquire a newly constructed facility. Neither Taxpayer nor Parent have any current intention to sell or otherwise dispose of the RP after it is acquired. Taxpayer proposes to effect the exchange as follows:

On Date 1, Taxpayer will set up a qualified exchange accommodation arrangement (QEAA) by entering into an agreement (QEAA Agreement) with Company. Under the QEAA Agreement, LLC will accept an assignment from Parent, on the same date, of a Leasehold Interest in Site Y located in Town X, State B (the "Leasehold Interest"). Also, on or about Date 1, Taxpayer will enter into an exchange agreement with Company (the "Exchange Agreement").

The Leasehold Interest was never the property of Taxpayer. The Leasehold Interest was acquired by Parent on Date X under a ground lease with Landlord, who is unrelated to Parent and Taxpayer. Under the laws of State B, the Leasehold Interest is a real property interest.

When acquired on Date 1, Site Y will be unimproved except for demolition of the existing building on the site, and rough grading (all to be performed by Landlord). Under the ground lease, Parent acquired the right to occupy and use Site Y for a period of twenty (20) years with four (4) five-year renewal options and to construct on Site Y certain types of real property improvements, which would be owned by Parent or its assignee.

Under Parent's supervision, LLC will construct and own a single story x square foot C Facility building pursuant to plans and designs provided by Parent (the "Improvements"). The completion of the construction of the Improvements is anticipated to occur on Date 2 (a date within 180 days after the earlier of the transfer of RQ to QI or the date LLC acquires title to the Leasehold Interest). Record title to the Leasehold Interest and Improvements will be held by LLC beginning on or about Date 1 until a date not later than Date 2. Under the QEAA Agreement, Taxpayer has the right and the obligation to acquire and take title to the Leasehold Interest and the Improvements from LLC on or before Date 2.

Under the Exchange Agreement, Taxpayer will assign to QI the right to sell RQ to an unrelated buyer, pursuant to the terms and conditions of a purchase (sale) agreement. On or about Date 1, Taxpayer will convey RQ to a buyer and the buyer will be notified in writing of Taxpayer's assignment of its contract rights to QI. At the time of the conveyance, RQ will not be encumbered by any indebtedness. The proceeds from the sale of RQ (the "qualified funds") will be held by QI and deposited to an account at Bank A in the sole name of QI. Under the Exchange Agreement, Taxpayer has no right to receive, pledge, borrow or otherwise receive the benefits of the qualified funds. Taxpayer will also make a written assignment to QI of its right to acquire the Leasehold Interest and Improvements under the QEAA Agreement, and QI will make monthly disbursements to LLC from the qualified funds to permit LLC to make payments to the general contractor constructing the Improvements. None of the qualified funds disbursed by QI to LLC to pay construction costs will be paid to Taxpayer or to Parent, except for the planning costs to be paid to Parent.[1]

[1] On Date 1, when Parent assigns the Leasehold Interest to LLC, Parent will invoice LLC for approximately $X, representing the third-party planning costs Parent has already paid in planning the construction of the Improvements on Site Y (the "planning costs"). LLC will treat such costs as costs associated with the LLC's construction of the Improvements. Parent will not invoice or seek to be reimbursed by LLC for an additional $Z in third-party costs incurred by Parent to acquire Site Y. Parent also will not seek to be reimbursed for the substantial internal staff costs incurred by Parent in connection with the due diligence review and the acquisition of Site Y. LLC will pay Parent the invoiced amount of $X for the planning costs after LLC acquires title to the Leasehold and LLC receives the first advance of qualified funds from QI for costs of constructing the improvements.

Company is engaged in the business of providing exchange accommodation services as a qualified intermediary (QI) and as an exchange accommodation titleholder (EAT). Company is independent of and unrelated to Taxpayer and Parent and will be paid a fee for its services as QI and EAT.

Site Y, the intended site for the construction of Improvements, was originally ground leased to Parent by an unrelated person on arm's length commercial terms. The remaining term of the ground lease for the C Facility site will exceed thirty (30) years (including renewal options) when LLC, at the direction of QI, transfers title to the Leasehold Interest and the Improvements to Taxpayer on Date 2 to complete the exchange.

Under the QEAA Agreement, EAT and not the Taxpayer will report for federal and state income tax purposes the attributes of its ownership interest in the Leasehold Interest and the Improvements, as they are constructed during the 180-day safe harbor period. LLC will not file a tax return because it is a disregarded entity that is wholly owned by EAT (Company). During the period that LLC holds title to the Leasehold Interest, LLC will pay any rent and other leasehold charges that come due and LLC also will pay the real estate taxes that accrue during such period.

Under the Exchange Agreement, the Taxpayer will identify within the 45-day period set forth in § 1031(a)(3) in a written instrument delivered to QI the legal description for the Leasehold Interest and a general description of the Improvements to be constructed on the Leasehold Interest, while it is owned by LLC.

Under the QEAA Agreement, the Taxpayer will identify, within the 45-day period beginning on Date 1, the RQ disposed of under the Exchange Agreement as the real property being exchanged for the RP held under the QEAA Agreement.

QI will not take title to either the RQ or to the RP. However, at both the closing of the disposition of the RQ and the subsequent closing of the acquisition of the RP, Taxpayer will give written notice, respectively, to the buyer of the RQ and to EAT (as the seller of the RP) of Taxpayer's assignments of its contract rights (to sell RQ and to buy RP) to QI, as permitted by §1.1031(k)-1(g)(4)(v).

Within one hundred eighty (180) days after the earlier of (i) the conveyance of the RQ, and (ii) LLC's acquisition of the RP in the form of the Leasehold Interest and Improvements, the Taxpayer will acquire under the Exchange Agreement and the QEAA Agreement the Leasehold Interest and the Improvements to complete the Exchange.

Under the QEAA Agreement, the purchase price to be paid by Taxpayer for the acquisition of RP will be equal to the costs incurred by LLC in constructing the Improvements and acquiring the Leasehold Interest, including capitalized costs such as accrued real estate taxes, rent and the planning costs. The final purchase price to be paid by Taxpayer will be determined immediately before Date 2.

To the extent the actual purchase price exceeds the qualified funds held by QI, the excess purchase price will be paid in cash by Taxpayer or will be paid by Taxpayer by assuming the outstanding indebtedness of LLC for the construction period expenses. To the extent the estimated cost of the Improvements is less than the qualified funds held by QI, if Taxpayer does not timely identify and acquire an additional like-kind replacement property, Taxpayer will receive the remaining qualified funds as boot.

APPLICABLE LAW:

General Requirements for Deferral under §1031.

Section 1031(a)(1) 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 that is to be held either for productive use in a trade or business or for investment. Thus, for a transaction to qualify under §1031, the properties must be: (1) exchanged; (2) held for productive use in a trade or business or for investment; and (3) of a like kind.

Ordinarily, to constitute an exchange, the transaction must be a reciprocal transfer of property as distinguished from a transfer of property for a money consideration only. See §1.1002-1(d) of the Income Tax Regulations. Under the given facts, there will be an exchange in which Taxpayer will receive property for property rather than money for property. The facts also indicate that both the property to be transferred as RQ and the property to be received as RP are properties held or to be held for use in Taxpayer's trade or business.

Section 1.1031(a)-1(b) of the regulations defines like-kind as referring to the nature or character of the property and not to its grade or quality. Section 1.1031(a)-1(c)(2) provides that no gain or loss is recognized if a taxpayer who is not a dealer in real estate exchanges city real estate for a ranch or farm, or exchanges a leasehold of a fee with 30 years or more to run for real estate, or exchanges improved real estate for unimproved real estate.

In the present case, Taxpayer is exchanging a fee interest in improved real estate for a long-term lease of a tract of land for a period of more than 30 years and improvements. Accordingly, the property to be transferred and the property to be received by Taxpayer are of like kind.

However, when the exchange is not simultaneous, the statute imposes additional conditions for satisfying the requirement that the exchanged property be of like kind.

Section 1031(a)(3) provides that property received by the taxpayer is not treated as like-kind property if it: (a) is not identified as property to be received in the exchange on or before the day that is 45 days after the date on which the taxpayer transfers the relinquished property; or (b) is received after the earlier of the date that is 180 days after the date on which the taxpayer transfers the relinquished property, or the due date (determined with regard to extension) of the transferor's federal income tax return for the year in which the transfer of the relinquished property occurs.

In addition, under general tax accounting principles, if money or other property is actually or constructively received by a taxpayer or an agent of a taxpayer before receiving like-kind replacement property, the disposition of the relinquished property will be treated as a sale under §1001. Because the transaction at issue in the present case has elements of both a deferred exchange and a reverse (or “parking”) transaction, further provisions of the deferred exchange regulations at §1.1031(k)-1 and Rev. Proc. 2000-37, 2000-40 I.R.B. 308, are applicable for testing whether the transaction qualifies for deferral of gain (or loss) realized under §1031.

Applicable Deferred Exchange Regulations.

Section 1.1031(k)-1provides rules for deferred like-kind exchanges under §1031(a)(3). Section 1.1031(k)-1(a) provides that a deferred exchange is an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the “relinquished property”) and subsequently receives property to be held for productive use in a trade or business or for investment (the “replacement property”). In the case of a deferred exchange, if the requirements set forth in §1031(a)(3) (relating to identification and receipt of replacement property) are not satisfied, the replacement property received by the taxpayer will be treated as property which is not of a like kind to the relinquished property.

Section 1.1031(k)-1(c)(2) generally provides that replacement property is identified only if it is designated as replacement property in a written document signed by the taxpayer and hand delivered, mailed, telecopied, or otherwise sent before the end of the identification period to either the person obligated to transfer the replacement property to the taxpayer or any other person involved in the exchange other than the taxpayer or a disqualified person. Examples of persons involved in the exchange include any of the parties to the exchange, an intermediary, an escrow agent, and a title company. An identification of replacement property made in a written agreement for the exchange of properties signed by all parties thereto before the end of the identification period will be treated as satisfying the requirements. Replacement property is identified only if it is unambiguously described. Real property is unambiguously described if it is described by a legal description, street address, or distinguishable name. However, §1.1031(k)-1(c)(1) provides, in part, that any replacement property that is received by the taxpayer before the end of the identification period will in all events be treated as identified before the end of the identification period.

Section 1.1031(k)-1(d)(1) provides, in part, that the identified replacement property is received before the end of the exchange period if the taxpayer receives the replacement property before the end of the exchange period, and the replacement property received is substantially the same property as identified.

Section 1.1031(k)-1(e)(1) provides that a transfer of relinquished property in a deferred exchange will not fail to qualify for nonrecognition of gain or loss under §1031 merely because the replacement property is not in existence or is being produced at the time the property is identified as replacement property. For purposes of §1.1031(k)-1(e)(1), the terms "produced" and "production" have the same meanings as provided in §263A(g)(1) and the regulations thereunder.[2]

Section 1.1031(k)-1(e)(2) provides that in the case of replacement property that is to be produced, the replacement property must be identified as provided in §1.1031(k)-1(c) (relating to identification of replacement property). For example, if the identified replacement property consists of improved real property where the improvements are to be constructed, the description of the replacement property satisfies the requirements of §1.1031(k)-1(c)(3) (relating to description of replacement property) if a legal description is provided for the underlying land and as much detail is provided regarding construction of the improvements as is practicable at the time the identification is made.

Section 1.1031(k)-1(e)(3)(i) generally provides that for purposes of §1.1031(k)-1(d)(1)(ii) (relating to receipt of the identified replacement property), in determining whether the replacement property received by the taxpayer is substantially the same property as identified where the identified replacement property is property to be produced, variations due to usual or typical production changes are not taken into account. However, if substantial changes are made in the property to be produced, the replacement property received will not be considered to be substantially the same property as identified. Section 1.1031(k)-1(e)(3)(iii) further provides that if the identified

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[2] Section 263A(g)(1) states that the term “produce” includes construct, build, install, manufacture, develop or improve. In this regard we note that even before §1.1031(k)-1 was promulgated, courts permitted taxpayers great latitude in structuring exchange transactions under §1031 in “build-to-suit” situations. Thus, a taxpayer can locate suitable property to be received in an exchange and can enter into negotiations for the acquisition of such property. *Coastal Terminals, Inc. v. United States*, 320 F.2d 333, 338 (4th Cir. 1963); *Alderson v. Commissioner*, 317 F.2d at 790 (9th Cir. 1963); *Coupe v. Commissioner*, 52 T.C. 394 (1969). A party can hold transitory ownership of exchange property solely for the purposes of effecting the exchange. *Barker v. Commissioner*, 74 T.C. 555 (1980). Moreover, the taxpayer can oversee improvements on the land to be acquired, *J.H. Baird Publishing Co. v. Commissioner*, 39 T.C. 608 (1962), and can even advance money toward the purchase of the property to be acquired by exchange. *124 Front Street Inc. v. Commissioner*, 65 T.C. 6 (1975); *Biggs v. Commissioner*, 632 F.2d 1171 (5th Cir. 1980), *aff'g* 69 T.C. 905 (1978). The Service has also approved certain exchange transactions in which the replacement property was built to suit the requirements of the exchanging taxpayer. For example, in Rev. Rul. 75-291, 1975-2 C.B. 332, a corporation (X) agreed to exchange its land and factory for land to be purchased by another (Y) and improvements to be constructed thereon. The ruling stated that Y “built the factory solely on its own behalf” and “not as an agent of the taxpayer.” X was allowed nonrecognition treatment.

replacement property is real property to be produced and the production of the property is not completed on or before the date the taxpayer receives the property, the property received will be considered to be substantially the same property as identified only if, had production been completed on or before the date the taxpayer receives the replacement property, the property received would have been considered to be substantially the same property as identified. Even so, the property received is considered to be substantially the same property as identified only to the extent the property received constitutes real property under local law.

Section 1.1031(k)-1(f)(1) generally provides that a transfer of relinquished property in a deferred exchange is not within the provisions of §1031(a) if, as part of the consideration, the taxpayer receives money or other property. However, such a transfer, if otherwise qualified, will be within the provisions of either §1031 (b) or (c). In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives like-kind replacement property. If the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property.

Section 1.1031(k)-1(f)(2) provides, in part, that except as provided in §1.1031(k)-1(g) (relating to safe harbors), for purposes of §1031 of the Code and §1.1031(k)-1 of the regulations, the determination of whether (or the extent to which) the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made under the general rules concerning actual and constructive receipt and without regard to the taxpayer's method of accounting. In addition, actual or constructive receipt of money or property by an agent of the taxpayer (determined without regard to §1.1031(k)-1(k)) is actual or constructive receipt by the taxpayer.

Section 1.1031(k)-1(g)(2) through (g)(5) sets forth a variety of safe harbors for use in deferred exchange situations. The use of one or more of these safe harbors in a deferred exchange will shield a taxpayer from actual or constructive receipt of money or other property.

In the present case, Taxpayer will use the qualified intermediary safe harbor as described in §1.1031(k)-1(g)(4). Section 1.1031(k)-1(g)(4)(i) provides that in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for purposes of §1031(a). In such a transaction, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange and the determination of whether the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer.

Section 1.1031(k)-1(g)(4)(ii) states that the qualified intermediary safe harbor applies only if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary as provided in §1.1031(k)-1(g)(6).

Section 1.1031(k)-1(g)(4)(iii) defines the term "qualified intermediary" as a person, not the taxpayer or a disqualified person (as defined in §1.1031(k)-1(k)), who enters into a written agreement with the taxpayer (the "exchange agreement") and, as required by the exchange agreement, acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.[3]

Section 1.1031(k)-1(g)(4)(iv)(A) provides that, regardless of whether an intermediary acquires and transfers property under general tax principles, solely for purposes of §1.1031(k)-1(g)(4)(iii)(B), an intermediary is treated as acquiring and transferring property if the intermediary acquires and transfers legal title to that property. Section 1.1031(k)-1(g)(4)(iv)(B) provides that an intermediary is treated as acquiring and transferring the relinquished property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with a person other than the taxpayer for the transfer of the relinquished property to that person and, pursuant to that agreement, the relinquished property is transferred to that person. Section 1.1031(k)-1(g)(4)(iv)(C) provides that an intermediary is treated as acquiring and transferring replacement property if the intermediary (either on its own behalf or as the agent of any party to the transaction) enters into an agreement with the owner of the replacement property for the transfer of that property and, pursuant to that agreement, the replacement property is transferred to the taxpayer.

Section 1.1031(k)-1(g)(4)(v) provides that solely for purposes of §1.1031(k)-1(g)(4)(iii) and (iv), an intermediary is treated as entering into an agreement if the rights of a party to the agreement are assigned to the intermediary and all parties to that agreement are

[3] Section 1.1031(k)-1(k)(1) defines the term "disqualified person" as a person described in §1.1031(k)-1(k)(2), (k)(3), or (k)(4). Essentially, a disqualified person is an agent of the taxpayer, or a person related to the taxpayer or the agent. Generally, a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the relinquished properties is treated as an agent of the taxpayer at the time of the transaction. However, for purposes of this definition, performance of the following services are not taken into account --

(i) Services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under §1031; and

(ii) Routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

notified in writing of the assignment on or before the date of the relevant transfer of property. For example, if a taxpayer enters into an agreement for the transfer of relinquished property and thereafter assigns its rights in that agreement to an intermediary and all parties to that agreement are notified in writing of the assignment on or before the date of the transfer of the relinquished property, the intermediary is treated as entering into that agreement. If the relinquished property is transferred pursuant to that agreement, the intermediary is treated as having acquired and transferred the relinquished property.

The Parking Transaction under Rev. Proc. 2000-37.

Rev. Proc. 2000-37 sets forth a safe harbor for acquiring replacement property under a QEAA sometimes referred to as a “parking” transaction. As provided in this safe harbor, the Service will not challenge either (a) the qualification of the property as either replacement or relinquished property (as defined in §1.1031(k)-1(a)), or (b) the treatment of the EAT as the beneficial owner if the property is held in the QEAA as defined in section 4.02 of Rev. Proc. 2000-37. As provided in section 4.02 of the revenue procedure, property is held in the QEAA if all of the following requirements are met:

(1) Qualified indicia of ownership of the property is held by a person (the EAT) who is not the taxpayer or a disqualified person and either such person is subject to federal income tax or, if such person is treated as a partnership or S corporation for federal income tax purposes, more than 90 percent of the entity is owned by partners or shareholders who are subject to federal income tax. Such qualified indicia of ownership must be held by the EAT at all times from the date of acquisition by the EAT until the property is transferred as described in section 4.02(5) of Rev. Proc. 2000-37. For this purpose, "qualified indicia of ownership" means legal title to the property, other indicia of beneficial ownership of property under applicable principles of commercial law (e.g., a contract for deed), or an interest in an entity that is disregarded as an entity separate from its owner for federal income tax purposes (e.g., a single member limited liability company) and that holds either legal title to the property or such other indicia of ownership;

(2) At the time the qualified indicia of ownership of the property is transferred to the EAT, it is the taxpayer's bona fide intent that the property held by the EAT represent either replacement property or relinquished property in an exchange intended to qualify for nonrecognition of gain (in whole or in part) or loss under §1031;

(3) No later than five business days after the transfer of qualified indicia of ownership of the property to the EAT, the taxpayer and the EAT enter into a written agreement (the "QEAA Agreement") providing that the EAT is holding the property for the benefit of the taxpayer in order to facilitate an exchange under §1031 and Rev. Proc. 2000-37 and that the taxpayer and the EAT agree to report the acquisition, holding, and disposition of

the property as provided in Rev. Proc. 2000-37. The agreement must specify that the EAT will be treated as the beneficial owner of the property for all federal income tax purposes. Both parties must report the federal income tax attributes of the property on their federal income tax returns in a manner consistent with this agreement;

(4) No later than 45 days after the transfer of qualified indicia of ownership of the replacement property to the EAT, the relinquished property is properly identified. Identification must be made in a manner consistent with the principles described in §1.1031(k)-1(c). The taxpayer may properly identify alternative and multiple properties, as described in §1.1031(k)-1(c)(4);

(5) No later than 180 days after the transfer of qualified indicia of ownership of the property to the EAT, (a) the property is transferred either directly or indirectly through a qualified intermediary (as defined in §1.1031(k)-1(g)(4)) to the taxpayer as replacement property; or (b) the property is transferred to a person who is not the taxpayer or a disqualified person as relinquished property; and

(6) The combined time period that relinquished property and replacement property are held in the QEAA does not exceed 180 days.

Pursuant to section 4.03 of Rev. Proc. 2000-37, property will not fail to be treated as held in the QEAA as a result of any one or more of the following legal or contractual arrangements (listed below, in part, as relevant to the given facts), regardless of whether such arrangements contain terms that typically would result from arm's length bargaining between unrelated parties with respect to such arrangements:

(1) An EAT that satisfies the requirements of the qualified intermediary safe harbor set forth in §1.1031(k)-1(g)(4) may enter into an exchange agreement with the taxpayer to serve as the qualified intermediary in a simultaneous or deferred exchange of the property under §1031;

(2) The taxpayer or a disqualified person guarantees some or all of the obligations of the EAT, including secured or unsecured debt incurred to acquire the property, or indemnifies the EAT against costs and expenses;

(3) The taxpayer or a disqualified person loans or advances funds to the EAT or guarantees a loan or advance to the EAT; and

(4) The taxpayer or a disqualified person manages the property, supervises improvement of the property, acts as a contractor, or otherwise provides services to the EAT with respect to the property.[4]

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[4] Other types of contractual arrangements, omitted here for want of relevance under these facts, are permissible within the QEAA under section 4.03 of Rev. Proc. 2000-37.

APPLICATION AND ANALYSIS:

The proposed transaction involves a related party to Taxpayer (Parent) which provides by transfer to QI part of the property that is to become RP.[5] However, since both Taxpayer and Parent continue to be invested in exchange properties, both will remain so invested for a period of not less than two years following the exchange, and neither is otherwise cashing out its interests, gain recognition is not triggered under §1031(f)(4).

In addition, the qualified exchange accommodation arrangement safe harbor (the QEAA) provided by Rev. Proc. 2000-37 applies to the proposed transaction. Taxpayer will also use the qualified intermediary safe harbor as set forth in the deferred exchange regulations under §1.1031(k)-1(g)(4).

In the present case, a qualified indicia of ownership of RP will be held by LLC in compliance with all requirements stated in section 4.02(1) of Rev. Proc. 2000-37. Taxpayer represents as its bona fide intent, now and at the time the qualified indicia of ownership of RP is transferred to LLC, that the property held by LLC will constitute replacement property in an exchange qualifying for nonrecognition of gain (in whole or in part) or loss under §1031, consistent with section 4.02(2) of Rev. Proc. 2000-37.

Within five days after the transfer of RP to LLC, Taxpayer will enter into a QEAA Agreement with an EAT providing that EAT (acting through LLC) will serve as EAT by acquiring RP as required by section 4.02(3) of Rev. Proc. 2000-37. Taxpayer represents that EAT (and LLC) will not be a disqualified person as defined by §1.1031(k)-1(k).

In addition, Taxpayer will enter into an exchange agreement with QI to facilitate transfer of RQ to a third party in the exchange transaction as permitted by §1.1031(k)-1(g)(4). Under this provision, QI will not be the agent of the taxpayer for purposes of §1031(a). Thus, Taxpayer’s transfer of relinquished property through a qualified intermediary and

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[5] Section 1031(f)(1) provides:
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 occurs.

the subsequent receipt or deemed receipt of like-kind replacement property through a qualified intermediary will be treated as an exchange.

All timing requirements necessary for property to be held in the QEAA, relating to notice and transfer of qualified indicia of ownership of the property to LLC will be satisfied. Within 45 days after the transfer of RP to EAT, Taxpayer will identify RQ as required by section 4.02(4) of Rev. Proc. 2000-37. Also, as required by section 4.02(5) of Rev. Proc. 2000-37, no later than 180 days after the transfer of qualified indicia of ownership of RP to LLC, RP will be transferred to Taxpayer. Consistent with section 4.02(6) of Rev. Proc. 2000-37, RQ will not be held by LLC or EAT in a QEAA and the total time that LLC will hold RP will not exceed 180 days. RP will be received by Taxpayer at or about the same time as the transfer of RQ to the third party through QI. Therefore, Taxpayer will receive RP before the earlier of: (1) 180 days after the date on which the taxpayer transfers RQ in the exchange, or (2) 180 days after the date on which RP is transferred to LLC pursuant to the QEAA agreement.

As permitted by section 4.02(1) of Rev. Proc. 2000-37, the qualified indicia of ownership of RP will be held by EAT through LLC, a disregarded entity it wholly owns. EAT is and will be subject to federal income tax and is not Taxpayer or a disqualified person. Parent will transfer Leasehold Interest to LLC. One or more contractors hired and supervised by LLC will construct improvements on such property. Leasehold Interest, together with such improvements constructed by and for LLC, will constitute RP. Once construction is completed, RP will be transferred to Taxpayer to complete the exchange.

Section 1.1031(k)-1(e)(1) provides that a transfer of relinquished property in a deferred exchange will not fail to qualify for nonrecognition of gain or loss under §1031 merely because RP is not in existence or is being produced at the time the property is identified as replacement property. Section 1.1031(k)-1(e)(2)(i) requires a taxpayer to identify RP by providing a legal description of the underlying land that is subject to sublease and as much detail as is practicable regarding the construction of the improvements at the site.

Taxpayer will receive no money or other property directly, indirectly or constructively prior to or during the exchange and will receive no economic benefit of money or property other than that derived from the exchange. One possible exception will be if other property is transferred to Taxpayer incident to the failure of the contractors to timely complete improvements on RP prior to its transfer to Taxpayer. In that event, Taxpayer will have taxable boot in addition to any like-kind replacement property received in the exchange. Also, to the extent the estimated cost of the Improvements is less than the qualified funds held by QI, if Taxpayer does not timely identify and acquire additional like-kind replacement property, Taxpayer will receive the remaining qualified funds as boot.

RULING:

Accordingly, based on the documents presented, including the exchange agreement with QI, the QEAA Agreement with EAT setting up the QEAA, and all other representations made, Taxpayer's transaction will conform with the requirements of the qualified intermediary and the QEAA safe harbor rules, so that QI and EAT will not be agents of Taxpayer and Taxpayer will not be in actual or constructive receipt of money or other property before receiving RP. Taxpayer will not recognize any gain or loss upon the conveyance of RQ to a third party and the receipt of RP. However, if planned improvements are not completed within the exchange period, gain will be recognized to the extent of any boot received in the exchange. Also, to the extent the estimated cost of the Improvements is less than the qualified funds held by QI, if Taxpayer does not timely identify and acquire additional like-kind replacement property, Taxpayer will receive the remaining funds as boot. Gain would then be recognized to the extent of such boot.

CAVEATS AND EXCEPTIONS:

Except as specifically provided above, no opinion is expressed as to the federal tax treatment of the transaction under any other provisions of the Internal Revenue Code and the Income Tax Regulations that may be applicable or under any other general principles of federal income taxation. Neither is any opinion expressed as to the tax treatment of any conditions existing at the time of, nor effects resulting from, the transaction that are not specifically covered by the above ruling. No opinion is expressed as to whether the accommodators used in this transaction are disqualified persons as defined in §1.1031(k)-1(k), as that would constitute essentially a factual determination. This ruling assumes that QI and EAT are eligible to serve as exchange accommodators.

This ruling is directed only to the taxpayer(s) who requested it. Section 6110(k)(3) provides that it may not be cited as precedent. Pursuant to a Power of Attorney submitted by Taxpayer, a copy of this letter will be sent to Taxpayer's authorized representatives.

Sincerely yours,

Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: