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Department of the Treasury

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B05

PLR-137528-04

Date:

February 24, 2005

TY:

LEGEND

Trust =

Decedent =

\$X =

Year A =

X Beneficiaries =

Date A =

Date B =

Date C =

Date D =

Date E =

Date F =

Date G =

State A =

State B =

X percent =

Y percent =

Z percent =

LLC =

Relinquished Property =

\$Y =

Buyer =

QI =

Dear _____ :

This is in response to your request for a private letter ruling dated June 30, 2004, submitted by your authorized representatives as to the application of § 1031(a) of the Internal Revenue Code to the proposed transaction. Specifically, you have requested a ruling that a testamentary trust may hold replacement property received in this like-kind exchange of real property “for productive use in a trade or business or for investment” within the meaning of § 1031(a) notwithstanding that the trust must terminate by its own terms and thus distribute all of its properties, when the like-kind exchange is independent of the impending termination.

The following facts are pertinent to your ruling request. The Taxpayer is a private testamentary trust (“Trust”) established by Decedent upon his death in Year A to administer his assets. Decedent’s will provided for the establishment of the Trust in order to provide an ongoing source of safe and certain income to its beneficiaries, which included Decedent’s wife and daughters. Under the terms of Decedent’s will, the Trust will terminate at midnight on Date A, which is twenty years after the death of Decedent’s last surviving child. Because the Trust is due to terminate, the trustees of the Trust (“Trustees”) formulated a detailed Plan of Termination, which outlines a plan and mechanism for the distribution of the Trust’s assets to its remainder beneficiaries upon its termination. Trust presently has X beneficiaries. Trust is required to distribute all of its income currently, may not make any other distributions to charitable or other beneficiaries, and is taxed as a “simple trust” under § 651.

Originally, the assets of the Trust consisted mainly of real estate holdings in State A. The submission provides that, in order to diversify the Trust’s real estate holdings, increase investment returns, and generate income, the Trustees received approval from the State A probate court many years ago to conduct exchanges of real estate. The Trustees have engaged in many such exchanges, which have been structured to qualify for nonrecognition treatment under § 1031. Trust intends to continue to enhance its investment operations by strategically exchanging certain assets in its portfolio. As a result, the assets in the Trust now include real estate holdings in State A and diversified industrial, office, and retail properties located in other states. Your submission states that all of the Trust’s directly-owned properties are held for investment purposes. Recently, the value of the Trust’s assets approximated \$X.

Under the Plan of Termination, approximately X percent of the Trust will be distributed on termination in cash to certain remainder beneficiaries. Y percent of the Trust will be distributed on termination through an in-kind distribution of one or more Trust properties to one expected remainder beneficiary. The remaining corpus (approximately Z percent) of the Trust’s net asset value will be contributed by the Trustees prior to termination to LLC, a to-be-formed State B limited liability company, with the Trust as

the single member holding all of the shares in the LLC. All of the shares in LLC will then be distributed upon termination by the Trust among the remainder beneficiaries (to the extent their remainder interest is not otherwise satisfied with cash or in-kind property). LLC is intended to continue the Trust's real estate investment operations in a manner consistent with past practices. It is expected that much of the current managerial and operational structure will remain in place after the Trust terminates. The submission also provides that as a result of the large number of real estate parcels and the large number of beneficiaries, the Plan of Termination can only be effected by contributing the assets to an entity prior to and in conjunction with the Trust's terminating distributions. The Trustees submitted the Plan of Termination to the State A probate court, which approved it on Date B.

The Trustees have determined that it would be in the best interests of the Trust to dispose of the Relinquished Property in an exchange that would qualify for nonrecognition under § 1031. The Relinquished Property includes the facilities and underlying land, together with all rights and appurtenances pertaining to the facilities and land.

The Trust entered into a disposition agreement dated Date C with Buyer to dispose of the Relinquished Property for \$Y in cash. The Trust transferred Relinquished Property to Buyer on Date D. One day earlier, the Trust assigned its interest in the disposition agreement to QI, a qualified intermediary for purposes of the safe harbor provided in § 1.1031(k)-1(g)(4) of the Income Tax Regulations, pursuant to an "Assignment and Assumption Agreement." The Trust also entered into "Exchange Agreement" with QI in order to facilitate the disposition of the Relinquished Property and the identification and acquisition of suitable replacement properties in accordance with the safe harbor deferred exchange regulations under § 1031.

According to the submission, once identified and acquired in completion of the exchange, the Trustees intend to hold the replacement property solely to generate additional rental income and have no plans to develop or construct any improvements on the property, or to sell the replacement property or any portion of it at any time. Pursuant to the Plan of Termination, the Trustees will convey the replacement property to LLC sometime on or before Date E and will distribute all of the Trust's interests in LLC to certain beneficiaries on Date G (or as soon thereafter as possible). In addition, the Trust makes the following representations:

- (1) The Relinquished Property now and at all times during the Trust's ownership thereof, has been held by the Trust for investment purposes;
- (2) The disposition of the Relinquished Property and the acquisition of the replacement property will be accomplished in a manner that in all respects (aside from the future conveyance to LLC and the distribution of LLC to the beneficiaries of Trust upon termination) qualifies the transaction as a tax-free exchange within the meaning of §1031 and the regulations thereunder;

- (3) The replacement property will be of "like kind" to the Relinquished Property for purposes of §1031 and will be held by the Trust (and then LLC) for investment purposes throughout the Trust's existence; and
- (4) LLC will not elect to be taxed as a corporation and will remain a single member LLC until at least Date A at which time it will be deemed to become a partnership for federal income tax purposes as a result of the Trust's terminating distribution of the membership interests of LLC to multiple beneficiaries.

Law and analysis

As stated above, you have requested a ruling that the Trust may hold replacement property received in this like-kind exchange of real property "for productive use in a trade or business or for investment" within the meaning of § 1031(a) notwithstanding that the Trust must terminate by its own terms and distribute all of its properties, when the like-kind exchange is independent of the impending termination.

Section 1031(a)(1) 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 the property is exchanged solely for property of a like kind which is to be held either for productive use in a trade or business or for investment. Under § 1.1031(a)-1(b) relating to the meaning of the term "like kind," real property is generally considered to be of like kind to all other real property, whether or not any of the real property involved is improved.

In Rev. Rul. 75-292, 1975-2 C.B. 333, an individual taxpayer in a prearranged transaction transferred land and buildings used in the taxpayer's trade or business to an unrelated corporation in exchange for land and an office building owned by the corporation and used in its trade or business. Immediately thereafter, the individual taxpayer transferred the land and office building to the individual's newly created corporation in exchange for the stock of the same corporation in a transaction that qualified for nonrecognition of gain under § 351. The revenue ruling concluded that the individual taxpayer did not exchange the real estate for other real estate to be held either for productive use in a trade or business or for investment by that taxpayer. Instead, the ruling concluded that the replacement property was acquired by the individual taxpayer for the purpose of transferring it to the new corporation in exchange for stock pursuant to § 351. As a result, the ruling held that, as to that individual taxpayer, the exchange did not qualify for nonrecognition under § 1031.

In Rev. Rul. 77-337, 1977-2 C.B. 305, an individual taxpayer owned all of the stock of a corporation. In a prearranged plan, the individual taxpayer liquidated the corporation and transferred the corporation's sole asset, a shopping center, to a third party in exchange for like-kind property. Rev. Rul. 77-337 noted that under Rev. Rul. 75-292, a newly created corporation's eventual productive use of property in its trade or business is not attributable to its sole shareholder. Rev. Rul. 77-337 thus concluded that the transaction between the individual taxpayer and the third party was a prearranged plan whereby the corporation was liquidated to facilitate the further exchange between the

individual taxpayer and the third party of their respective properties. Consequently, the individual taxpayer did not hold the shopping center for use in a trade or business or for investment because the corporation's previous trade or business use could not be attributed to its sole shareholder. Therefore, the exchange did not qualify for nonrecognition of gain or loss under § 1031.

Wagensen v. Commissioner, 74 T.C. 653 (1980), pertains in part to an exchange of real property, a ranch, for like-kind property followed by a gift of the newly acquired ranch property to the taxpayer's children. The court found that the exchange qualified under § 1031. The ranch properties in question were held for use in a trade or business or for investment by taxpayer both before and after the exchange.

Under § 301.7701-3(b)(1)(ii), a domestic eligible entity is generally (with exceptions noted) disregarded as an entity separate from its owner if it has a single owner.

Section 301.7701-2(c)(2) provides that, in general, a business entity that has a single owner and is not a corporation (as defined in § 301.7701-2(b)) is disregarded as an entity separate from its owner for federal tax purposes.

Your submission expresses two concerns regarding the above exchange. Your first concern is that the proposed transfer of the replacement property to LLC would violate the holding requirement of § 1031(a) (i.e., that the replacement property must be held by the taxpayer for productive use in a trade or business or for investment) as applied in Rev. Rul. 75-292 and Rev. Rul. 77-337. Your second concern is that, as a result of the Trust's terminating distribution of membership interests in LLC to multiple beneficiaries, which will then result in a *de facto* partnership between the beneficiaries for federal income tax purposes, the holding requirement of § 1031(a) as applied in the revenue rulings would be violated with respect to the replacement property.

With respect to your first concern, you represent that the replacement property will be held by the Trust (and LLC) for investment purposes throughout the Trust's existence. You also represent that LLC will not elect to be taxed as a corporation and will remain a single member LLC until at least Date A. Therefore, LLC will be disregarded as an entity separate from the Trust, its sole owner. Consequently, the transfer by the Trust of the replacement property to LLC will also be disregarded, and the Trust will be considered the direct owner of the replacement property for federal income tax purposes. Because the Trust represents that it intends to hold the replacement property for investment purposes, the transfer by the Trust of the replacement property to LLC will not violate the holding requirement of § 1031(a).¹

With respect to your second concern, the Trust represents that it will hold the replacement property for investment purposes until the Trust terminates by its own

¹ No ruling is requested on the factual question of whether any specific replacement property is held for a particular purpose.

terms on Date A. Because the Trust is a testamentary trust, the termination date was fixed by Decedent and cannot be modified or changed. As a result, the Trust is not acquiring the replacement property in order to dispose of the property pursuant to a prearranged plan. The Plan of Termination has been approved by the State A probate court and will take effect without regard to whether this exchange of properties is consummated. Consequently, the like-kind exchange in this case is wholly independent from the distribution of the properties under the Plan of Termination. Thus, the facts in this ruling request are distinguishable from those in Rev. Rul. 75-292 and Rev. Rul. 77-337.

Therefore, based on the facts and representations presented above, we rule that the Trust's termination and distribution of its assets to the beneficiaries will not preclude the replacement property received by the Trust in this exchange from being considered property held either for productive use in a trade or business or investment, within the meaning of § 1031, because this like-kind exchange is independent of the impending termination.

No determination is made by this ruling letter as to whether the described transaction otherwise qualifies for deferral of gain realized under § 1031. We express no opinion, except as specifically ruled above, as to the federal income tax treatment of the transaction under any other provisions of the Code and 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, or effects resulting from, the transaction(s) that are not specifically covered by the above ruling.

You should attach a copy of this ruling to your tax return for the taxable year in which the transaction covered by this ruling is consummated. We are enclosing a copy for that purpose.

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. This ruling is directed only to the taxpayers who requested it.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely yours,

By: Roy A. Hirschhorn
Assistant Branch Chief, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)