

Private Letter Ruling
Number: **200251008**
Internal Revenue Service
September 11, 2002

Internal Revenue Service
Department of the Treasury
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This responds to your letter, dated January 29, 2002, requesting a ruling on the proper federal income tax treatment of a proposed like-kind exchange of real property, as supplemented by letters and submissions dated February 22, March 20, May 16, June 3, June 14, and August 9, 2002. Taxpayer requests a ruling under § 1031 of the Internal Revenue Code that no gain or loss will be recognized upon the conveyance of Relinquished Property (RQ) to Village and the receipt of Replacement Property (RP).

APPLICABLE FACTS:

Taxpayer is an S corporation, organized under the laws of State A, which operates Business on a calendar year basis, using the accrual method of accounting. Business is situated on RQ. Taxpayer owns a fee interest in RQ, with all improvements thereon.

CorpW, an S corporation organized under the laws of State A, currently leases A-Acres situated on Unimproved Real Property located in City and County under a Lease and Development Agreement ("Lease"), as amended, with City. Lease's term is 45 years from the commencement date (which was on or about September 2, 1997), and one 15-year renewal option.

LLC-W, a State A limited liability company, subleases A-Acres from CorpW and all rights, title, interest and obligations under Lease, for the entire term of Lease. LLC-W plans to utilize A-Acres, in part, as the new location for Business that presently exists on RQ. LLC-W is currently developing and constructing the infrastructure required so that Business can be moved to A-Acres.

Taxpayer and CorpW are related parties, each owned half and half by Husband's Trust and Wife's trust, respectively. LLC-W is also related to Taxpayer, owned 45%, 45% and 10%, respectively, by Husband's Trust, Wife's Trust and Minority Member.

Village and Taxpayer entered into an Option Agreement for Sale and Purchase (Sale Agreement) of RQ on December 12, 2001, and December 13, 2001, respectively. Under Sale Agreement, Taxpayers agreed to sell RQ to Village for \$B. However, Taxpayer is arranging to have this transaction (the transfer of RQ to Village) structured as a component of a like-kind exchange under § 1031 of the Code. Taxpayer will structure the exchange utilizing the qualified exchange accommodation arrangement (the QEAA) safe harbor provided in Rev. Proc. 2000-37, 2000-40 I.R.B. 308, with an exchange accommodation titleholder (EAT) and its wholly owned subsidiary, Titleholder. 1 Taxpayer will also use the qualified intermediary safe harbor rules of the deferred exchange regulations at § 1.1031(k)-1(g)(4) of the Income Tax Regulations, by entering into an exchange agreement with a qualified intermediary (QI). EAT and QI are both State A limited liability companies, wholly owned by Holding Company, a State B limited Partnership. Initially, the QEAA will be between Taxpayer and EAT. Later, Taxpayer's rights under the QEAA will be assigned to QI to facilitate transfer of RP from EAT to Taxpayer. The additional entity mentioned above, Titleholder, will be established for this

exchange transaction, specifically to take title to RP. Titleholder will be a limited liability company, with EAT as its sole member, and disregarded for federal income tax purposes.

1 This letter frequently describes events using the future tense even though, in some instances, the events described or anticipated have occurred, or will already have occurred by the date of issuance.

The exchange will occur as follows: LLC-W will sublease C-Acres (which is part of A-Acres), at a market rental rate, for a fixed term of 32 years to Titleholder as part of the QEAA. EAT will cause Titleholder to construct RP improvements on C-Acres. Taxpayer will identify RQ within 45 days of Titleholder entering into the sublease as provided in Rev. Proc. 2000-37, in a manner consistent with § 1.1031(k)-1(c).

Under the QEAA, Titleholder will enter into a contract with LLC-W (who will act as Construction Manager and contract on behalf of Titleholder with independent subcontractors) to construct RP improvements based on Taxpayer's plans and specifications. In addition, Titleholder will utilize the Bank Construction Loan (described below) to finance the construction of RP improvements by executing a note payable to Taxpayer, thereby obligating itself to pay Taxpayer for draw requests paid to Construction Manager. The cost to construct RP improvements will approximate \$B.

The Bank Construction Loan, in the amount of \$E, will be funded by Bank, with Taxpayer as maker and primary obligor. LLC-W and CorpW, together with Husband and Wife, will be guarantors of the Bank Construction Loan.

Subsequent to the commencement of the construction, Taxpayer will assign its rights under Sale Agreement of RQ to QI and give notice of such assignment to all parties to such agreement in writing, all as provided in § 1.1031(k)-1(g)(4)(v) of the regulations. Taxpayer will then transfer RQ to Village, as provided in the exchange agreement with QI. Taxpayer will retain liability on the underlying full recourse mortgage on RQ of approximately \$D by agreement with Bank. RQ will then be transferred by QI to Village free and clear. Village will pay the purchase price for RQ to QI and QI will receive and hold in escrow the proceeds from the sale of RQ. RQ constitutes substantially all of Taxpayer's assets. Village will not assume any liabilities of Taxpayer incident to the purchase.

To complete the exchange, Taxpayer will assign its rights to receive RP under the QEAA to QI. Thereupon, QI will direct that EAT transfer RP directly to Taxpayer. EAT will effect this transfer by transferring all of its ownership interest in Titleholder directly to Taxpayer. Through this series of transactions, QI will purchase RP from EAT using all the proceeds from the sale of RQ. EAT (through Titleholder) will use all of the proceeds from the sale of RQ to pay Construction Manager for construction and services and pay the loan from Taxpayer in full. Taxpayer will use the repayment proceeds to fully pay Bank Construction Loan before EAT transfers Titleholder to Taxpayer.

Because Titleholder is a disregarded entity for federal tax purposes, EAT will be deemed to enter into any contract Titleholder enters into and to perform any activity Titleholder performs. Furthermore, a transfer of all the interest in Titleholder will be treated as a transfer of the assets of Titleholder. Therefore, any reference herein to the transfer of RP properly refers to the transfer of all the interests of EAT in Titleholder to Taxpayer.

None of the accommodators to be used to implement the proposed exchange (QI, EAT, Titleholder) are disqualified persons as defined in § 1.1031(k)-1(k). Also, EAT, Titleholder and QI are subject to federal income tax or, if such persons are treated as partnerships or S corporations for federal income tax purposes, more than 90% of its interest or stock are owned by partners or shareholders who are subject to federal income tax. Services to be performed for Taxpayer by EAT, Titleholder and QI, with respect to exchanges of property are intended to facilitate exchanges that qualify for nonrecognition of gain or loss under § 1031.

No later than five business days after the transfer of a qualified indicia of ownership of exchange property (RP) to EAT, Taxpayer and EAT will enter into a written agreement (setting up the QEAA) providing that EAT is holding RP in order to facilitate an exchange under § 1031 and Rev Proc. 2000-37, and that Taxpayer and EAT agree to report the

acquisition, holding and disposition of the property as provided in that revenue procedure. The QEAA will specify that EAT will be treated as the beneficial owner of the property for all federal income tax purposes and that Taxpayer and EAT will report the federal income tax attributes of the property on their federal income tax returns in a manner consistent with the terms of the QEAA.

Pursuant to the QEAA, Taxpayer will exchange RQ for RP. RP will be real property that consists of a 32-year sublease of C-Acres and specifically identified buildings and improvements on C-Acres to be utilized as part of the relocated Business. The QEAA will also provide that Titleholder will enter into a fixed term 32-year sublease with LLC-W and pay rent to LLC-W at a market rate of rent for C-Acres of land, which is a portion of A-Acres. All improvements to be constructed on RP will be with the approval of City, County, and Bank where required.

No later than 180 days after the transfer of the qualified indicia of ownership of RP to Titleholder (wholly owned by EAT), Titleholder will be transferred directly to Taxpayer. If the production of the identified RP is not completed by Titleholder on or before the 180-day period has expired, EAT will be required by the agreement to transfer all of its interest in Titleholder prior to the completion to Taxpayer in order to comply with the requirements of Rev. Proc. 2000-37. The agreement between Taxpayer and EAT will expressly limit Taxpayer's rights to receive, pledge, borrow or otherwise obtain the benefits of money or other property held by EAT or Titleholder in a manner consistent with the requirements of § 1.1031(k)-1(g)(4)(ii) and (g)(6). EAT will hold qualified indicia of ownership of RP, as defined in Rev. Proc. 2000-37, (through Titleholder) and such qualified indicia of ownership will be held by EAT at all times from the date of acquisition by EAT until the property is transferred to Taxpayer. At the time the qualified indicia of ownership of the property is transferred to EAT, it is Taxpayer's bona fide intent that the property held by EAT represent RP in an exchange that is intended to qualify for nonrecognition of gain (in whole or part) or loss under § 1031.

In addition to entering into the QEAA, Taxpayer will enter into a written agreement, the exchange agreement, with QI. The exchange agreement will require QI to acquire RQ from Taxpayer and transfer RQ to a purchaser, and to acquire RP and transfer RP to Taxpayer. Pursuant to the exchange agreement, and as provided in § 1.1031(k)-1(g)(4)(iv) and (v), Taxpayer will assign its rights under Sale Agreement (of RQ to Village) to QI, assign its rights under the QEAA to receive RP also to QI, and give proper and timely notice of these assignments to all parties of Sale Agreement and to all parties of the QEAA. Pursuant to these agreements, assignments and notices, RQ will be transferred, through QI, to Village, and Taxpayer will receive, through QI, complete ownership of RP by the transfer of all ownership interest in Titleholder. The exchange agreement between Taxpayer and QI will also require that Taxpayer will have no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property (in particular the proceeds resulting from the sale of RQ to Village) held by QI except as provided in § 1.1031(k)-1(g)(6). Furthermore, since Taxpayer will transfer RQ and receive RP simultaneously, the transaction will effectively satisfy the time requirements in § 1031(a)(3). Also, RP will not remain in QEAA for a period exceeding 180 days.

The entire proposed transaction at issue can be summarized in the following steps: (1) Taxpayer will enter into the QEAA with EAT, and will enter into an exchange agreement with QI as described. (2) LLC-W will sublease RP at a fair market rental, for 32 years, to Titleholder, a disregarded entity wholly owned by EAT, as part of a QEAA as defined in Rev. Proc. 2000-37. (3) Taxpayer will lend to Titleholder the funds which it (Taxpayer) will borrow from Husband's Trust, Wife's Trust and Bank to construct improvements necessary on leased property for relocation of Business. (4) Taxpayer will assign its rights under Sale Agreement of RQ to QI and will give required notices of such assignment to all interested parties. (5) Taxpayer will transfer RQ free and clear through QI to Village, and QI will receive sales proceeds. (6) Taxpayer will assign its position in the QEAA to QI and give required notices of such assignment to all interested parties. (7) QI will use sales proceeds from RQ to pay EAT for all of its interest in Titleholder (which holds all of RP, consisting of leased property and newly constructed improvements to suit Taxpayer's business requirements). (8) EAT will use the proceeds received from QI (the consideration for the transfer of RP (Titleholder)) to pay Construction Manager and to pay the loan from Taxpayer in full (which Taxpayer will, in turn, use to pay the Bank Construction Loan in full). (9) QI will direct EAT to transfer its interest in Titleholder (holding RP) directly to Taxpayer.

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.

In accordance with this provision, for a transaction to have the effect of deferring gain or loss under § 1031, it must (1) constitute an exchange, (2) the property transferred and the property received must be held for productive use in a trade or business or for investment, and (3) the property exchanged must be 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 regulations. Under the given facts, there will be an exchange in which the 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 Income Tax 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, such properties are of like kind for § 1031 purposes, provided the requirements of § 1031(a)(3) are satisfied.

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 of the Code. 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 are applicable for testing whether the transaction qualifies for deferral of gain (or loss) realized under § 1031.

Applicable Deferred Exchange Regulations.

On April 25, 1991, the Service issued final regulations under § 1.1031(k)-1 providing rules for deferred like-kind exchanges under § 1031(a)(3) of the Code. Section 1.1031(k)-1(a) of the regulations 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) of the regulations 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) of the regulations 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) of the regulations 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

2 Section 263A(g)(1) of the Code states that the term "produce" includes construct, build, install, manufacture, develop or improve. In this regard we note that even before these regulations (§ 1.1031(k)-1(e)) were 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), affg. 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.

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 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) of the regulations 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) of the regulations. 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

3 Section 1.1031(k)-1(k)(1) of the regulations 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.

Section 1.1031(k)-1(g)(4)(iv)(A) provides that, regardless of whether an intermediary acquires and transfers property under general tax principals, 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 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.

On September 15, 2000, the Service issued Rev. Proc. 2000-37, 2000-40 I.R.B. 308, setting 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) of the regulations) 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 "exchange accommodation titleholder") 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 its interests or stock are owned by partners or shareholders who are subject to federal income tax. Such qualified indicia of ownership must be held by the exchange accommodation titleholder at all times from the date of acquisition by the exchange accommodation titleholder 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 interests 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 exchange accommodation titleholder, it is the taxpayer's bona fide intent that the property held by the exchange accommodation titleholder represent either replacement property or relinquished property in an exchange that is 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 exchange accommodation titleholder, the taxpayer and the exchange accommodation titleholder enter into a written agreement (the "qualified exchange accommodation agreement") that provides that the exchange accommodation titleholder 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 exchange accommodation titleholder agree to report the acquisition, holding, and disposition of the property as provided in Rev. Proc. 2000-37. The agreement must specify that the exchange accommodation titleholder 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 exchange accommodation titleholder, 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 exchange accommodation titleholder, (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 exchange accommodation titleholder 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 exchange accommodation titleholder, including secured or unsecured debt incurred to acquire the property, or indemnifies the exchange accommodation titleholder against costs and expenses;

(3) The taxpayer or a disqualified person loans or advances funds to the exchange accommodation titleholder or guarantees a loan or advance to the exchange accommodation titleholder; 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 exchange accommodation titleholder with respect to the property. 4

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 is a parking transaction between related parties (Taxpayer and LLC-W). 5 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, although the exchange itself is expected to be simultaneous.

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.

Since both Taxpayer and the related parties continue to be invested in the exchange properties, and are not otherwise cashing out their interest, § 1031(f)(1) is not a concern for this transaction unless and until Taxpayer or the related parties dispose of their interests in the exchanged property within two years after the last transfer that was part of the exchange.

In the present case, a qualified indicia of ownership of RP will be held by EAT in compliance with all requirements stated in section 4.02(1) of Rev. Proc. 2000-37. It is and will be Taxpayer's bona fide intent, now and at the time the qualified indicia of ownership of RP is transferred to EAT, that the property held by EAT represent 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 EAT, Taxpayer will enter into the QEAA with an EAT providing that EAT (through Titleholder) will acquire RP as required by section 4.02(3) of Rev. Proc. 2000-37. Taxpayer represents that EAT will not be a disqualified person as defined by § 1.1031(k)-1(k) of the Code.

In addition, Taxpayer will enter into an exchange agreement with QI to facilitate transfer of RQ to Village in the exchange transaction as permitted by § 1.1031(k)-1(g)(4) of the regulations. Under this provision, a qualified intermediary is not considered the agent of the taxpayer for purposes of § 1031(a). Thus, Taxpayer's transfer of relinquished property through a qualified intermediary and the subsequent receipt or deemed receipt of like-kind replacement property through a qualified intermediary is 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 EAT, 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 EAT, RP will be transferred to Taxpayer. Consistent with section 4.02(6) of Rev. Proc. 2000-37, RQ will not be held by EAT in a QEAA and the total time that EAT will hold RP will not exceed 180 days. Moreover, RP will be received by Taxpayer simultaneously with its transfer of RQ through QI to Village. Therefore, Taxpayer will receive RP before the earlier of: (1) 180 days after the date on which the taxpayer transfers RQ in the exchange, (2) the due date (determined with regard to extension) for Taxpayer's tax return for the taxable year in which the transfer of RQ occurs, or (3) 180 days after the date on which RP is transferred to EAT under the QEAA.

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 Titleholder, another disregarded, single member LLC which it wholly owns. EAT is and will be subject to federal income tax and is not Taxpayer or a disqualified person. LLC-W is subleasing C-acres of the Unimproved Real Property to Titleholder. EAT and Titleholder will construct improvements on such property by one or more contractors hired and supervised by LLC-W. C-Acres (which is subleased from CorpW through LLC-W) together with such improvements, constructed by and for Titleholder, will constitute RP. Once EAT (and Titleholder through LLC-W) completes construction of improvements and the exchange of RP for RQ is completed, Taxpayer will take ownership of Titleholder (the disregarded entity holding title to RP).

Section 1.1031-1(e)(1) of the regulations 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)(1) 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. In the present case, however, the question of sufficiency of identification of replacement property does not arise because the exchange will be simultaneous, except to the extent the improvements to C-Acres are incomplete when RP is transferred to Taxpayer.

If the production of the identified RP is not completed by EAT on or before the date required to satisfy the requirements of Rev. Proc. 2000-37, EAT will be required by contract to transfer RP to Taxpayer to satisfy those requirements, prior to completion. If this occurs, the identification requirement will be satisfied because Taxpayer will receive RP simultaneously with its transfer of RQ.

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. The only 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 the transfer of Titleholder to Taxpayer. In that event, Taxpayer will have taxable boot in addition to its like-kind replacement property.

RULING:

Accordingly, based on the documents presented, including the exchange agreement with QI, the qualified exchange accommodation agreement with EAT setting up the QEAA, and all other representations made, Taxpayer's transaction will conform with the requirements of the QI 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 Village 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.

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 transactions 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 accommodators.

This ruling is directed only to the taxpayer(s) who requested it. Section 6110(k)(3) of the Code 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: