

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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Person To Contact: \_\_\_\_\_, ID No.

Telephone Number: \_\_\_\_\_

Refer Reply To:  
CC:ITA:B04  
PLR-163001-02

Date:  
June 29, 2005

Taxpayer =  
K =  
L =  
M Corp =  
State X =  
Year 1 =  
Year 2 =  
x =  
y =  
z =

Dear \_\_\_\_\_ :

This responds to your letter, dated October 22, 2002, requesting a private letter ruling as to the application of § 1031 of the Internal Revenue Code to the proposed transaction.

**FACTS:**

Taxpayer is an individual who was married to K. Together, they acquired substantial acreage in timberlands for investment. They divorced in Year 1, but continued holding this acreage as co-tenants. K died in Year 2.

M Corp is a State X holding company that conducts business through a number of wholly-owned subsidiaries that are engaged principally in owning and managing timberlands, harvesting timber and manufacturing and selling various wood products. M Corp acquired K's undivided one-half interest in the acres of timberlands.

M Corp has two classes of authorized stock, voting common and nonvoting common. All shares of voting common stock are held by L, the son of K and Taxpayer. Of the x shares now issued and outstanding of nonvoting common, Taxpayer owns y and L owns z. The majority of the remaining shares are held in trust by L for the benefit of the

lineal descendants of Taxpayer. Because all shares of the voting common and most shares of the nonvoting common are owned by Taxpayer or by or for her "family" (as that term is defined in § 267(c)(4)), either directly or by attribution pursuant to § 267(c)(2), Taxpayer is considered the owner of more than 50 percent of the value of the outstanding stock of M Corp. Therefore, M Corp and Taxpayer are related persons pursuant to §§ 267(b) and 1031(f)(3).

Taxpayer desires to hold the timberlands strictly as investment property. In furtherance of its timber business, M Corp wants to harvest any old-growth timber before it loses its value. To accommodate these conflicting interests, Taxpayer and M Corp propose to enter into a like-kind exchange in which Taxpayer's 100% interest in old-growth timberland will be exchanged for M Corp's 100% interest in reproduction timberlands of equal value. The exchange will allow Taxpayer to accommodate the business needs of M Corp while continuing to allow Taxpayer to hold timberlands for investment.

#### ISSUES:

1. Will the exchange of Taxpayer's 100% interest in old-growth timberlands held for investment, for M Corp's 100% interest in reproduction timberlands, also to be held for investment, constitute a like-kind exchange under § 1031?
2. Will the planned cutting by M Corp of the old-growth timber, whether or not pursuant to §§ 631(a) and (b), within two years of the exchange, require recognition of gain pursuant to § 1031(f)(1)?

#### LAW AND ANALYSIS:

In Hutchins v. King, 68 U.S. 53, 59 (1863), the Supreme Court stated that "timber growing upon the land constituted a portion of the realty." Additionally, in Laird v. United States, 115 F. Supp. 931 at 933 (W.D. Wis. 1953), growing timber on land was found to be part of the land.

Section 631(a) allows a taxpayer who owns, or has a contract right to cut, timber to elect to treat the cutting of timber as a sale or exchange of the timber in the year the timber is cut, provided the timber or the contract right to cut the timber is held for more than 1 year.

Section 631(b) provides that in the case of the disposal of timber held by the owner for more than 1 year under a contract by which the owner retains an economic interest in the timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss on the sale of the timber.

Section 1.631-1(e)(1) of the Income Tax Regulations provides that when products of timber are sold after cutting, such as logs or lumber, the income from such sales are considered ordinary income.

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 such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1031(f)(1) generally provides that 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 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 such subsequent disposition occurs.

Rev. Rul. 72-515, 1972-2 C.B. 466, provides that the exchange of unencumbered fee title to timberlands that differ in timber quality and quantity qualifies for nonrecognition of gain or loss under § 1031(a). In Rev. Rul. 72-515, virgin-growth timberlands were exchanged for second-growth timberlands. The exchange was determined to be of a like-kind because the quantity, quality, age, and species of the timber growing on the land may influence the grade or quality of the timberland involved in the exchange, but does not influence the kind or class of the property exchanged which in this case is land.

Rev. Rul. 2001-50, 2001-2 C.B. 343, provides that the cutting of timber during the 10-year recognition period does not trigger recognition of built-in gains under § 1374(d)(3) regardless of whether § 631 applies to the timber transaction or not. Section 1.1374-4(a) provides that § 1374(d)(3) applies to any gain recognized during the recognition period in a transaction treated as a sale or exchange for Federal income tax purposes.

The age, quality, and species of the timber growing on the land do not change the class or kind of the property being exchanged, which is land. Accordingly, the exchange between Taxpayer and M Corp of old-growth timberland for reproduction timberland will constitute a like-kind exchange under § 1031.

A disposition of the property exchanged between related persons within 2 years will cause recognition of gain under § 1031(f)(1). Under Rev. Rul. 2001-50, the cutting of timber is not a disposition that causes recognition of built-in gains.

In the instant case, after the cutting and disposition of the timber, M Corp will still own the underlying land that was exchanged in the proposed transaction. Accordingly, the planned cutting of the timber by M Corp will not trigger recognition of gain under § 1031(f) regardless of whether §§ 631(a) or (b) applies to the transaction.

**CAVEATS:**

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

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

Sincerely,

George F. Wright  
Assistant Branch Chief, Branch 4  
Office of Associate Chief Counsel  
(Income Tax & Accounting)