



Buyer 2 =

Dear :

This is in response to your request for a private letter ruling dated December 16, 2005, submitted by the authorized representatives of a testamentary trust ("Trust"). A ruling is requested that the like-kind exchange of real property undertaken by a limited liability company ("LLC") created by the Trust will not be precluded from qualifying for nonrecognition treatment under § 1031(a) of the Internal Revenue Code merely because the contract for the disposition of the relinquished property initially was entered into by the Trust prior to the Trust's termination.

The following facts are pertinent to your ruling request. Trust was 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 from investment returns 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 numerous remainder beneficiaries upon its termination.

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 since engaged in many such exchanges, which have been structured to qualify for nonrecognition treatment under § 1031. 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. The 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 State B limited liability company, with the Trust as the single member holding all of the shares in the LLC. Upon termination of the Trust, all of the shares in LLC will be distributed among certain (but not all) remainder beneficiaries (to

the extent their remainder interest is not otherwise satisfied with cash or in-kind property). LLC intends to continue the Trust's real estate investment operations in a manner consistent with past practices. It is represented that much of the current managerial and operational structure will remain in place after the Trust terminates. 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 exchange a few of the Trust's real estate investment properties each year in order to exercise their fiduciary duty to increase rental income. The Trust has 180 days to complete an exchange of properties by acquiring the replacement property pursuant to § 1031(a)(3)(B). Trust anticipates that, following the Trust's termination, LLC will continue to periodically conduct § 1031 exchanges. Trust has two exchanges that it expects it will be unable to close prior to its termination and, accordingly, desires to transfer its interests in these transactions to LLC for continuation post-termination. These two exchanges are the subject of this ruling request.

Exchange 1: On Date C, the Trust received an offer to purchase Relinquished Property 1 from Buyer 1. The acquisition price offered is \$Y but is subject to negotiation. A final sale contract between the parties will condition closing of the disposition of this property on the receipt of a favorable private letter ruling in response to this request and the receipt of final subdivision approval from the local authorities. Subdivision approval is expected by Date E, which is less than 180 days from the termination date of the Trust. Accordingly, the Trust will convey Relinquished Property 1 to the LLC pursuant to the Termination Plan and will also transfer its contractual rights to continue the disposition of Relinquished Property 1 and to acquire qualified § 1031 replacement property to LLC, which would then transact the entire exchange after Trust's termination.

Exchange 2: On Date D, the Trust entered into a non-binding Letter of Intent with Buyer 2 for the disposition of Relinquished Property 2. The acquisition price agreed to by the parties is \$Z. The Letter of Intent provides that the obligation of the Trust to complete the disposition of Relinquished Property 2 is contingent on the receipt of a favorable private letter ruling in response to this request and the receipt of final subdivision approval from the local authorities. Subdivision approval for Relinquished Property 2 is also expected by Date E, which is less than 180 days from the termination date of the Trust. Accordingly, the Trust will convey Relinquished Property 2 to the LLC pursuant to the Termination Plan and will also transfer its contractual rights to continue the disposition of Relinquished Property 2 and to acquire qualified § 1031 replacement property to LLC, which would then transact the entire exchange after Trust's termination.

Relinquished Property 1 and Relinquished Property 2 (collectively "Relinquished Properties") will be subject to separate exchange transactions. However, the submission represents that they can be treated identically for purposes of this ruling

request. The submission represents that for purposes of § 1031, replacement properties will be acquired (collectively “Replacement Properties”); however, these properties have not yet been identified or located for either of the exchange transactions.

As stated above, the Trust (subject to receipt of this private letter ruling) will transfer its interest in the Relinquished Properties’ sale contracts (the “Disposition Contracts”) to LLC for closing shortly after LLC becomes a multi-member LLC on or about the termination date of the Trust (Date A). LLC would then have the full 180 days to complete the exchanges by acquiring Replacement Properties. Consequently, pursuant to the Termination Plan, the Trustees will convey the Relinquished Properties (subject to the contractual obligations for disposition and exchange) to LLC on or before the end of the year, and will distribute all of the Trust’s interests in LLC to certain of its beneficiaries on the termination date (Date A), or as soon thereafter as practicable. Prior to the terminating distribution, the Trust will be the sole member of LLC. The contribution of the Relinquished Properties and assignment of the Disposition Contracts to LLC will have no federal income tax consequences. The LLC will be taxed like a partnership when the beneficiaries receive their interests.

The two subject exchanges will be structured to qualify as “deferred exchanges” under § 1.1031(k)-1 of the Income Tax Regulations and will comply with all of the requirements of those provisions. Prior to closing, the LLC will assign all of its rights in the Disposition Contracts with respect to the Relinquished Properties to an exchange intermediary. The LLC and the exchange intermediary will enter into an exchange agreement setting forth the terms and conditions under which the intermediary will dispose of each Relinquished Property and acquire each Replacement Property identified by the LLC.

As with the Relinquished Properties, the LLC will assign its rights to the Replacement Property acquisition contract(s) to the exchange intermediary and notify all parties to the contract(s) prior to closing. At closing, the intermediary will deposit the exchange funds with an escrow company and the seller(s) will deed the replacement property directly to the LLC.

In addition, the Trust makes the following representations:

- (1) The Relinquished Properties now and at all times during the Trust’s ownership thereof, have been held by the Trust for investment purposes;
  - (2) The disposition of the Relinquished Properties and the acquisition of the Replacement Properties will be accomplished in a manner that in all respects, aside from the issues raised in this ruling request, qualify the transactions as tax-free exchanges within the meaning of § 1031 and the regulations thereunder;
- and

- (3) The Replacement Properties will be of "like kind" to the Relinquished Properties for purposes of § 1031 and will be held by the LLC for investment purposes.

### Law and analysis

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. As stated above, you request a ruling that the like-kind exchange of real property by the LLC will not be precluded from qualifying for nonrecognition treatment under § 1031(a) merely because LLC receives the Relinquished Properties subject to the contracts for their disposition that were entered into by the Trust prior to the Trust's termination.

Section 1031 includes a "holding" requirement that both the relinquished property and the replacement property must be held either for productive use in a trade or business or for investment. In this case, each of the Relinquished Properties will be subject to a contract of disposition at the time the Trust will terminate and the properties will automatically transfer to the LLC. The primary concern is that the LLC would not meet the "holding" requirement of § 1031(a) with respect to the Relinquished Properties because the properties are subject to contracts for their disposition at the time they are received by the LLC.

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. 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 but that the taxpayer acquired the replacement property for the purpose of transferring it to the new corporation. As a result, the exchange did not qualify for nonrecognition under § 1031.

In Rev. Rul. 77-337, 1977-2 C.B. 305, in a prearranged plan, an individual taxpayer liquidated all the stock of a 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. 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, and the exchange did not qualify for nonrecognition of gain or loss under § 1031.

Section 1031 was designed, in part, to postpone the recognition of gain or loss when property used in a trade or business or held for investment is exchanged for other property in the course of the continuing operation of that trade or business, or in the course of investment. In those circumstances, the taxpayer has not received any gain or suffered any loss in a general and economic sense, nor has the exchange of property resulted in the termination of one venture and assumption of another. The business venture operated before the exchange continues after the exchange without any real economic change or alteration, and without realization of any cash or readily liquefiable asset. See Carlton v. United States, 385 F.2d 238 (5th Cir. 1967); Jordan Marsh Co. v. Commissioner, 269 F.2d 453 (2 Cir. 1959); cf. Portland Oil Co. v. Commissioner, 109 F.2d 479 (1 Cir.) cert. den., 310 U.S. 650 (1940). See generally § 1.1002-1(c) (“[t]he underlying assumption of these exceptions [e.g., § 1031] is that the new property is substantially a continuation of the old investment still unliquidated”).

In this case, after the Trust’s terminating distribution of membership interests in LLC to multiple beneficiaries, the resulting entity will be functionally like the Trust and will be treated as a partnership between the beneficiaries merely for federal income tax purposes. However, the members of LLC will be substantially identical to the Trust beneficiaries. LLC intends to continue the Trust’s real estate investment operations in a manner consistent with past practices. Primarily the same managerial and operational structure will remain in place after the Trust terminates. LLC will continue the current business practices of the Trust with respect to its real estate properties. These facts distinguish this case from Rev. Rul. 77-337.

Additionally, in this case, the Trust is terminating involuntarily by its own terms after many years in existence. Because the Trust is a testamentary trust, the termination date was fixed by Decedent and cannot be modified or changed. The Plan of Termination has been approved by the State A probate court and will take effect without regard to whether these exchanges involving Trust properties are consummated. According to your submission, the Trust has engaged in numerous § 1031 exchanges throughout the years. Consequently, the like-kind exchanges in this case are wholly independent from termination of the Trust and its distribution of the Relinquished Properties to the LLC, as successor entity, 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, which involve voluntary transfers of properties pursuant to prearranged plans.

Accordingly, because the LLC will continue with the real estate business previously conducted by the Trust and is functionally a continuation of the Trust, and because the like-kind exchanges here are independent of the impending termination of the Trust, we rule that under the specific facts and representations presented above, the transfer of

the Relinquished Properties to LLC subject to the contracts for their disposition will not violate the holding requirement of § 1031(a) with respect to the subject exchanges.

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  
Senior Technician Reviewer, Branch 6  
Office of Associate Chief Counsel  
(Income Tax & Accounting)