Internal Revenue Service

Number: **201015015**
Release Date: 4/16/2010

Index Numbers: 1033.01-00, 1033.02-00, 1033.03-00, 1033.06-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:05
PLR-133887-09

Date: Jan. 05, 2010

LEGEND:

Taxpayer	=
Property	=
State A	=
State B	=
State Agency A	=
State Agency B	=
Date 1	=
Date 2	=
Date 3	=
$$$	=

Dear

In a letter dated July 17, 2009, you requested a private letter ruling on behalf of Taxpayer under Revenue Procedure 2009-1. You asked that, pursuant to section 1033 of the Internal Revenue Code, Taxpayer not be required to recognize gain on funds it receives as a result of a putative involuntary conversion from the taking of certain real estate interests by a public authority.

FACTS

As set forth in the original ruling request and other documents and representations submitted, the relevant facts may be summarized as follows:

Taxpayer has held certain land in State A (hereinafter “Property”) for investment and development purposes since Date 1. Since that acquisition, State Agency A instituted eminent domain proceedings and asserted the right to acquire fee title to Property in connection with State Agency A’s intent to use part of Property for state-interested purposes. In litigation of that matter, on Date 2, State Agency A prevailed over Taxpayer; nevertheless, while State Agency A has established its legal right to condemn Property, it never actually did so.

Despite the foregoing events, Taxpayer negotiated and reached an agreement for commercial development of Property with another unrelated party. In doing so, Taxpayer determined that it was unlikely that State Agency A would ever exercise its right to condemn the property and even if the agency did, the condemnation award would then be appropriately adjusted.

Subsequently, in a separate development, State Agency B also determined that it may be necessary to acquire certain rights in Property for a different public purpose. The eminent domain claims of State Agency B are, by operation of law, superior to those of State Agency A.

In light of the State Agency B determination, on or before Date 3, Taxpayer and State Agency B negotiated an agreement granting State Agency B certain temporary easement rights for a term of years (with an option for limited extensions) and a permanent easement interest in Property (hereinafter the “Agreement”). Taxpayer will receive $$$ from State Agency B as consideration for the taking of those property rights. Notwithstanding the Agreement, State Agency A would continue to have the right to take a fee interest in pursuit of its purposes once the easement term of State Agency B in Property lapsed. As such, the State Agency A condemnation right constitutes an additional threat to Taxpayer’s interests in Property.

As a result of these significant encumbrances upon the Taxpayer’s interests and rights in Property, Taxpayer maintains that its ability to develop Property has been significantly and perhaps permanently proscribed; consequently, it intends to use the $$$ received pursuant to the Agreement to acquire and develop other real property. Taxpayer seeks nonrecognition treatment under section 1033 for the funds paid in consideration of the taking, and threat thereof, of its various rights in Property.

LAW AND ANALYSIS

Section 61(a) indicates that, except as otherwise provided in the income tax provisions of the Code, gross income means all income from whatever source derived. Gains from dealings in property are included among the specifically listed items of gross income. Section 61(a)(3).

Section 1033(a) provides, in part that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money or into property not similar or related in service or use to the converted property, the gain (if any) shall be recognized except to the extent provided.

Section 1033(a)(2)(A) allows a taxpayer to limit current recognition of gain with respect to property that is compulsorily or involuntarily converted into money. The recognized gain is limited to the excess of the amount realized upon such conversion over the cost of other property (qualified replacement property) similar or related in service or use to the converted property (or the cost of purchasing stock in the acquisition of control of a corporation owning such other property), purchased by the taxpayer within a specified period. Section 1033(a) (2) (B) generally requires the replacement property to be purchased during the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending 2 years after the close of the first taxable year in which any part of the gain upon the conversion is realized.

Section 1033(a)(2)(B) provides in part that the period referred to in subparagraph (A) shall be the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, whichever is the earlier, and ending generally 2 years after the close of the first taxable year in which any part of the gain upon the conversion is realized.

Section 1033 only defers gains resulting from compulsory or involuntary conversions. The conversion into money or other property must occur from circumstances beyond the taxpayer's control. C. G. Willis, Inc. v. Commissioner, 41 T.C. 468, 474 (1964), aff'd per curiam, 342 F.2d 996 (3d Cir. 1965). Thus, in an extreme example, a taxpayer who, in an attempt to obtain insurance proceeds, commits arson by voluntarily paying a third party to burn down the taxpayer's building is not entitled to the benefits of section 1033. Rev. Rul. 82-74, 1982-1 C.B. 110.

In a more routine example, in Rev. Rul. 69-654, 1969-2 C.B. 162, the Service concluded that a property owner who voluntarily consented to the subsequent

conversion of part of his property for the purpose of constructing a school as a condition to receiving approval for the development of his remaining property was not entitled to the tax benefits of section 1033 with regard to the sale of the land on which the school would be constructed. Therefore, if a taxpayer takes voluntary action to cause the conversion of the taxpayer's property into other property or money, such a conversion does not constitute an involuntary conversion within the meaning of section 1033.

Taxpayer has not intentionally failed to exercise or protect ownership rights with regard to Property; thus, it should not be precluded from the tax benefits of section 1033. The involuntary element of the statute is met.

The nature and intent of Taxpayer's intent in holding Property is also no bar to section 1033 treatment. In Rev. Rul. 83-70, 1983-1 C.B. 189, the taxpayer was the lessee under a net lease with a remaining term of fifteen years. Neither the lessee nor the lessor had a renewal option under the lease. The taxpayer used the leased property in its furniture storage business. Upon the involuntary conversion of its fifteen-year leasehold interest, the taxpayer acquired a fee simple interest in property that was also suitable for use in taxpayer's furniture storage business. The Service ruled that the fee interest in real property acquired by the taxpayer constituted "property similar or related in service or use" to the 15-year leasehold interest that had been involuntarily converted. The ruling was based on the fact that both the property subject to the fee interest and the property subject to the leasehold interest housed office and warehouse space and would be used by the taxpayer in its furniture storage business.

Under section 1033(g), for the purposes of subsection (a), if real property (not including stock in trade or other property held primarily for sale) held for productive use in trade or business or for investment is (as a result of its seizure, requisition, or condemnation, or threat or imminence thereof) compulsorily or involuntarily converted, property of a like kind to be held either for productive use in trade or business or for investment shall be treated as property similar or related in service or use to the property so converted.

The Service has expressly noted that the "like kind" standard of 1033(g), under which a leasehold interest qualifies as being of like kind to a fee interest only if the lease will continue at least 30 additional years, is separate and distinct from the "similar or related in service or use" standard under 1033(a)(2)(A); therefore, the requirement that a lease have a remaining term of at least 30 years is inapplicable to the determination of whether a fee interest is "similar or related in service or use" to a leasehold interest. *See Davis Regulator Co. v. Commissioner,* 36 B.T.A. 437 (1937), *acq.,*1937-2 C.B. 7; Rev. Rul. 64-237, 1964-2 C.B. 319 (discussing several

factors to consider in determining whether the replacement property is similar to the converted property of the owner-investor, including the nature of the business risks connected with the properties, and the extent and type of management activities the property requires of the owner; thus, when an investor's property is involuntarily converted, the investor is entitled to consider the manner in which the converted property was held in determining whether the proposed replacement property will be similar or related in service or use).

Taxpayer plans to use the fee simple property that it acquires with the proceeds from the takings of the temporary easements for the same purpose that it has used Property, i.e., holding for commercial development. Accordingly, like in Rev. Rul. 83-70, Taxpayer here would be permitted to treat the fee interest(s) acquired as "property similar or related in service or use" to Property. Investing in a fee simple interest for purposes of investment or development permits Taxpayer to continue to hold property that is similar or related in service or use. The right taken from the Taxpayer is not—as it was in Rev. Rul. 38, 1953-1 C.B. 16 (nonrecognition held unavailable)---the right to use the property in its current state; rather, it is the right to develop the property and realize the capital appreciation that may result from such development.

CONCLUSION

Under the facts and circumstances presented herein, State Agency B's taking of certain eminent domain rights in Property for a payment of $$$ is an involuntary conversion within the meaning of section 1033. If during the period specified in section 1033(g), the Taxpayer purchases with the proceeds realized real property similar or related in service or use, gain, if any, shall be recognized only to the extent provided in section 1033(a)(2)(A).

Further, we conclude that a fee interest in real property constitutes "property similar or related in service or use" to the easements involuntarily converted. Purchase of a fee interest with the proceeds, therefore, will defer recognition of those proceeds under section 1033. This ruling does not address the treatment of basis in Property under section 1033 (b) or any required holding period. See section 1223(1)(A).

This letter is directed only to the taxpayer that requested it. Section 6110(j)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it may be relevant, including the taxable year in which the replacement of the converted property is made. If Taxpayer files its return electronically, it may satisfy this

requirement by attaching a statement to the return that provides the date and control number of this letter ruling.

In accordance with the provisions of a power of attorney currently on file, the original of this letter is being sent to you as the authorized representative of Taxpayer.

Sincerely,

William A. Jackson
Chief, Branch 5
Office of Associate Chief Counsel
(Income tax & Accounting)