Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Date: DEC 3 1998

LEGEND

X =

P =

Date1 =

Date2 =

Date3 =

Year1 =

Year2 =

City =

$x =

$y =

$z =

$xx =

$yy =

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2 1

$xxx =

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This responds to your letter submitted on behalf of X and requesting rulings under § 1033 of the Internal Revenue Code.

FACTS

X owns, operates, and rents income producing properties, and owns, operates, and invests in manufacturing operations. During X's taxable year ending Date1, P condemned and took over X's warehouse facility in City in return for $x. Receipt of the condemnation award caused X to realize gain of $y. X elected to recognize $z for the year ending Date1, but to defer recognition of the remaining realized condemnation award gain of $xx under § 1033. To maintain the deferral, X had to reinvest $yy of the proceeds by Date2.

X purchased replacement property (Replacement Property) for $zz in Year1 and $xxx in Year2. X requested and received an extension of the replacement period until Date3. X is in serious negotiation to purchase property (Additional Replacement Property) with a purchase price in excess of the $yyy remaining of the proceeds required to be reinvested to defer the recognition of gain.

X and its shareholders are concerned about exposure to liability with respect to Replacement Property and Additional Replacement Property. Therefore, X plans to form one or more qualified subchapter S subsidiaries (QSubs) or limited liability companies (LLCs) with X as the sole owner. If a favorable letter ruling is received, X will transfer the Replacement Property and the Additional Replacement Property to the QSubs or LLCs. If one or more LLCs are formed, X will not elect under § 301.7701-3(c) of the Procedure and Administration Regulations to treat the LLCs as corporations for federal tax purposes. Instead, the LLCs would be disregarded as entities separate from X.

Based upon the facts submitted and the representations made, X requests that we rule that the transfer of the Replacement Property and the Additional Replacement Property to an entity (either a QSub or an LLC) disregarded as an entity separate from X for federal tax purposes will not be a taxable event for federal tax purposes.

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LAW AND ANALYSIS

Section 1033(a)(2)(A) provides that if property is compulsorily or involuntarily converted (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation) into money, and during the period specified in § 1033(a)(2)(B) the taxpayer purchases property similar or related in service or use to the converted property, then the taxpayer may elect to recognize gain only to the extent that the amount realized upon the conversion exceeds the cost of the replacement property.

Section 1361(b)(3)(B) provides that a qualified subchapter S subsidiary (QSub) is a domestic corporation that is not an ineligible corporation, if (1) an S corporation holds 100 percent of the stock of the corporation, and (2) that S corporation elects to treat the subsidiary as a QSub. Section 1361(b)(3) provides that a corporation that is a QSub is not treated as a separate corporation for federal tax purposes. Accordingly, all assets, liabilities, and items or income, gain, loss, deduction, and credit of the QSub will be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

Section 301.7701-3(b)(1)(ii) provides that a domestic eligible entity (a business entity not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8)) with a single owner is disregarded as an entity separate from its owner for federal tax purposes unless the entity elects to be treated as a corporation. If the entity is disregarded, its activities are treated in the same manner as those of a division of its owner and its assets will be treated as those of the owner.

CONCLUSION

The receipt of the Replacement Property and Additional Replacement Property by an entity wholly owned by X that is not respected as an entity separate from X for federal tax purposes will be treated as the receipt of real property directly by X for purposes of qualifying the receipt of the Replacement Property and the Additional Replacement Property for nonrecognition of gain under § 1033.

Except as specifically ruled above, no opinion is expressed or implied as to the federal tax treatment of the above transactions under any other provision of the Code. In particular, no opinion is expressed concerning whether X is, in fact, an S corporation for federal tax purposes or, if X forms a corporate subsidiary, whether the corporate subsidiary will be treated as a QSub for federal tax purposes. In addition, no opinion is expressed concerning whether the transaction discussed above otherwise meets the requirements for nonrecognition of gain treatment under § 1033.

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

Sincerely,

DANIEL J. COBURN
Assistant to the Branch Chief, Branch 1
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosures